



# CASE STUDY OF HEALTH SECTOR PRIVATIZATION

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Ulaanbaatar  
2004

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**OPEN SOCIETY FORUM**

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OPEN SOCIETY FORUM

# CASE STUDY ON EDUCATIONAL REFORM, RESTRUCTURING AND PRIVATIZATION\_\_\_\_\_

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## CASE STUDY RATIONALE

In light of the shortcomings of the current Mongolian policy development process in terms of policy development and decision-making based on quality and timely policy research, the Open Society Forum supports and funds policy research in various areas so as to raise the significance and improve the quality of such research. One of such areas is the privatization of the public sector. I would like to present one of such case studies to you – “Case Study of the Health Sector Restructuring, Reforms and Privatization”.

The general aim of this study is to reflect upon the successes, shortcomings, privatization lessons and further possibilities for privatized public sector organizations, reveal the influences affecting the privatization of the public sector and raise the public awareness of the privatization issues, thereby supporting properly conducted privatization in the public sector.

This book is primarily intended for researchers, students and decision-making level officials of donor organizations interested in this topic, but it is written in easily understandable language, and can therefore be used by anyone interested in this topic. Aside from Mongolian, we have also published the case study in English. This research offers detailed information regarding a number of conflicting questions and difficulties, which arose in the course of the restructuring, reforms and privatization in the health sector, in particular, in the process of privatization. The book has also reflected upon the consequences and outcomes of privatization and the current status of the privatized entities.

I would like to express gratitude to the researchers of the Economic Policy Research Society headed by Ch. Khashchuluun for successful completion of this project on request of the Open Society Forum, and making results thereof available to the readers.

Thanks are also due to the head of the Society of Mongolian Public Health Professionals Yo. Dungu for conducting a thorough review of this study, as well as to the language editor and translator, doctor of philosophy B. Batchuluun and to Gautam Yadama, Associate Professor of Social Work at the University of Washington at St. Louis for making valuable comments on the English version of the book.

We will be happy to take questions or comments regarding this book through our e-mail, [osf@soros.org.mn](mailto:osf@soros.org.mn).

P. Erdenejargal  
Open Society Forum  
Executive Director

## Introduction

The Institute of Economics of the National University of Mongolia in cooperation with the Economic Policy Research Society hereby introduce **“The Case Study of Restructuring, Reform and Privatization in the Health Sector”**, completed on the order of the Open Society Forum.

As the privatization of the health sector intensifies, it is important to study the process and implementation of the privatization of already privatized organizations, the changes, the progress and shortcomings, which have emerged after privatization, as well as the strong and the weak aspects of the privatizations process. It is equally important to reflect upon the conduct of further policy in this area.

The privatization of the health sector influences both the quality of the treatment and the types of health services, the price, supply of medicines to the public, their production and distribution. From a range of privatized production, distribution, treatment and health services companies in the health sector, the research team selected the **Emiin Uildver** Company (Pharmaceutical Plant), the **Mongolemimpex** company, and the **Bayanzurkh Hospital** and conducted case studies of the process of their privatization, the conflicting questions and difficulties, which emerged in the course of the privatization, and the results of the privatization in the context of materials outlining the policy and the legal environment of privatization in the health sector.

The case study is intended for persons involved in the implementation of the privatization process, policy makers, researchers and the general public.

The conclusions of this study are that of the members of the research team, and do not express the views of the Open Society Forum.

Please send your questions or comments regarding this report to the Economic Policy Research Society.

Director of the Economic Policy Research Society  
Ch. Khashchuluun



## Abstract

As the privatization of the health sector intensifies, it is important to study the process and implementation of the privatization of already privatized organizations, the changes, the progress and shortcomings, which have emerged after privatization, as well as the strong and the weak aspects of the privatizations process. It is equally important to reflect upon the conduct of further policy in this area.

The privatization of the health sector influences both the quality of the treatment and the types of health services, the price, supply of medicines to the public, their production and distribution. In order to discern this influence, the research team conducted a comparative study of companies in the sphere of medicines production and distribution, treatment and health services and analyzed the process of their privatization, the conflicting questions and difficulties, which emerged in the course of the privatization and the results and consequences of their privatization.

The study has the following 5 chapters:

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The short description of the content of each chapter is presented below.

**First chapter** details the structure and the peculiarities of the health sector, discusses the reasons for the privatization of the health sector, as reflected in the existing sequence of programmes for privatization and restructuring of the health sector. The chapter analyzes the legal environment of the health sector by considering legal acts concerned with the privatization and restructuring of the health sector, as well as with the operation of that sector. The chapter further sheds light on the content of decisions and programmes of the Mongolian Parliament, Government, Ministries and Agencies. An effort has been made to present the process, principles and policies related to the privatization of the health sector as shown in the existing documents and programmes. Finally, the chapter aims to highlight some of the outcomes and shortcomings of the privatization in restructuring of the public sector, and on this basis

offer a series of recommendations for the improvement of methods and policies in the further conduct of privatization.

**Second chapter** takes up the case of privatization of a company with large market share in the health sector and analyzes the process of its selection for privatization, as well as the implementation and results thereof. The chapter compares the reasons for the privatization of the Mongolemimpeks Company with the stated aims and reasons of the health sector privatization, and highlights in particular the documents and facts related to the privatization of that company. The chapter details documents, materials and case study results reflecting upon the structure of the company prior to privatization, the economic phenomena, which arose during the process of privatization, the difficulties the company has faced in the aftermath of privatization and the changes, which may need to take place in the future. In connection with the lessons arising from the company's privatization, the chapter offers detailed prescriptions for further policy development in this sector.

**Third chapter** discusses the privatization of the Emiin Uildver Company, which has a large market share on the medications production market. The chapter describes the history of the privatization and the market position of the company, presents research findings arising from the case study and gives relevant recommendations. The analysis of the market position of the Emiin Uildver Company is based on the research of the supply and demand tendencies on the medications market, while the research findings are based on the case study of activities of the aforementioned company. On the basis of these findings, the chapter discusses the impact of the privatization of the Emiin Uildver Company and outlines options and proposals for further policy development in this sector.

**Fourth chapter** takes up the case of an organization, providing services in the health sector, a hospital. Since the Bayanzurkh Hospital is the first organization to be privatized in the sector, on the basis of pilot regulations, it was absolutely essential to study the experiences of this organization. The research outlines both the positive and the negative aspects of the legal environment and the process of management privatization. The study gives an assessment of the hospital's operations both prior and after the privatization. Finally, the chapter outlines proposals for further policy development in this sector.

**Fifth chapter** discusses the outcomes of pilot privatization projects carried out in the countryside. The chapter highlights the reasons why the pilot privatization projects, began in the soums in 1997 with the aim of improving the quality of medical services, as well as the economic viability of the relevant institutions in the countryside, stopped in 1999. On the basis of the appraisal conducted by the Ministry of Health and Social Security, the chapter outlines recommendations for further policy development in this sector.

# A case study of the privatization of the Bayanzurkh Hospital

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## 1. Process of the privatization

### 1.1. Legal environment

In september 1996, the State Property Committee, the Ministry of Finance, the former Ministry of Health and Welfare, and the Ministry of Science, Technology, Education and Culture in cooperation with the World Bank began the first project to privatize the social sector of Mongolia. In the same month a new work group was established. This work group was managed by A. Zangad, state secretary of the Ministry of Health and Welfare, and he took responsibility for creating the health sector “Reform and Privatisation Guidelines.” The group decided that the health sector pilot project be Bayanzurkh District Hospital, where the management would be carried out by contract.

On April 8, 1997, the Council of Health and Welfare Minister discussed and supported the project of “Privatisation Guidelines in the Health sector” to the Government Hural. It was introduced with the issue of privatizing the Bayanzurkh District Hospital.

With plans to implement the “Social Sector Reform and Privatization Guidelines,” the health sector pilot privatization program was launched in 1997, under the Government Resolution No 160. Within the pilot exercise, the Bayanzurkh District Hospital was to be managed either by the private sector or individuals on a contract basis. Under articles 34 and 58 of the May 27, 1996 Law on State and Local Property, the management contract was drawn for a period of three years.

... The pilot project’s results and experience of management privatization that covers this hospital will have to establish the basic model of district hospital service and activity. This will be the significance of the pilot privatization ...

*Evaluation of Bayanzurkh Hospital’s half year activity  
Department of Information, Monitoring-Analysis*

### 1.2. Tender

In April 20, 1997 Jerome Kasangrande, Consultant of the World Bank, and S. Sonin, Executive director of the Department of Economic Policy and Coordination created a tender and a mock management contract for the project to privatize the Bayanzurkh District Hospital.

. . . Many countries' experience has shown that the quality of service and economic efficiency of the hospital improves as non-government organizations and private sectors manage healthcare organizations by flexible and advanced manners under management contracts.

*The tender to manage Bayanzurkh District Hospital by private sector*

Information about the Bayanzurkh District Hospital privatization and the announcement of the tender were published in the "News of Government" on April 23 and 29, 1997. In addition, an interview of government officials regarding planned privatization was broadcasted by the State Radio of Mongolia.

On May 5, 1997 at 4pm, the tender was officially announced and the tender project and the mock management contract were distributed. As many as 25 people took these materials during the announcement of the tender.

For the people interested in the tender, a trip was organized on May 8, 1997 to become familiar with the Bayanzurkh District Hospital and detailed interviews with all physicians and workers were arranged on May 9, 1997.

On June 10, 1997 within the order A/217 of Minister of Health and Welfare, "Tender Selection Commission" was approved and the Minister ordered the commission to select the proposals, to negotiate with selected participants and to sign the management contract.

The proposals of the tender were evaluated in two stages: preliminary and final selection. In the first stage, the proposals were evaluated and selected on the basis of the terms and conditions of the tender. In the second stage, the final selection, the main criterion was "the suggested wage of the management team". It was mentioned in the tender that the participant, suggesting the minimum wage of the management team, would be selected.

Eight teams participated in the tender for the management contract of Bayanzurkh Hospital and the management team of the Mongolian Hospital Management (MHM) Company received the tender. The director of MHM Company is B. Dash-Yandag.

In May 1997, the Ministry of Health and Social Welfare (currently Ministry of Health) and the City of Ulaanbaatar Health Department asked for tenders for the management contract of Bayanzurkh District Hospital. The tender had the following purposes:

1. To improve the efficiency of the hospital's service

- a. To establish a non-governmental and advanced management system
  - b. To use flexible methods of management
  - c. To use qualitative monitoring systems to keep disciplines of the organization
2. To use an accounting system in the hospital
- a. To classify the hospital service through contents and quantitative indicators and to evaluate them by qualitative criteria
  - b. To guarantee the access to health service
  - a. To sustain the creativity of employees

#### Management skills

Health services and hospital management were very weak. This was not important when the role of the director was simply to implement policies and instructions received from the central level. Under central planning, the role of the managers was simply to ensure that targets, established at the central level, were met. There was practically no consideration for cost-efficiency, cost-content and other economic aspects of health services management. Hospital directors are usually doctors with no special training in management.

*Mongolia: Health Sector Reforms and the Private Sector,  
Jacques Juegmans, Senior Social Sector Specialist, ADB*

On July 1, 1997, as a part of the pilot project, Bayanzurkh District Hospital was privatized on the basis of a management contract valid for a period of three years. The Bayanzurkh District Governor Office, the City of Ulaanbaatar Health Department and the new Hospital Management Team signed the management contract.

### **1.3. Further activity**

The contract, signed with Bayanzurkh Hospital management, expired on July 1, 1999. Operations of the hospital and performance standards under the contract were discussed at the meeting of Council of the Health Minister in April 2000. Before that time, the process of the pilot privatization was discussed twice. The pilot exercise was assessed and the decree of Health Minister A/184 was approved.

In the decree of the Minister A/184, the Minister concluded that the Bayanzurkh Hospital management team successfully achieved the obligations outlined by the contract and extended the new management contract for two years. Since the legal envi-

ronment of future privatization in the social sector is not yet complete, the report of Bayanzurkh Hospital management team has been discussed each year since 2001 and the management contract has been extended for a year each time.

In the first two years of the contract, each section had contract managers. These managers monitored the performance under the contract but had no ability to influence each other's activities. Therefore, the hospital management team established the Board of Directors with the overall responsibility of monitoring the performance of the contract, instead of the responsibility on the part of individual contract managers.

... Although the operation of the hospital had been successful under the Bayanzurkh Hospital management contract, there are some difficulties and problems, which have adverse effects on the process of privatization, depending on workers of the Health Organization and work group of the Ministry of Health.

- Some difficulties and problems have arisen because employees at high and medium levels of management are not familiar with the term "management privatization and implementation under contract" as a unified term and the legal environment is not yet complete
- Some difficulties and problems stem from the use of an accounting system for the first time in a hospital
- There have been some obstacles in the operation of the hospital, because of the problems about the debt of hospital, which should have been settled at the preparation stage of privatization but have not been settled until now.

*Evaluation of Bayanzurkh Hospital's half year activity  
Department of Information, Control-Analysis*

The Board of Directors consists of seven members, from the City of Ulaanbaatar Health Department, the Bayanzurkh District Governor Office, representative of Bayanzurkh Hospital (from physician and workers), the Department of City Social Insurance, and the Department of City Consumer Rights Protection.

The Board of Directors takes responsibility for monitoring the performance of the management contract and makes sure that the hospital performs well.

... International Accounting System was tested in a hospital and balances in the third and fourth quarters of 1997 of Bayanzurkh Hospital were calculated by a new method...

...In accordance with the approved budget, 106.7 million MNT was allocated for spending, but only 103.3 million MNT was spent in 1997. The hospital worked with budget savings of 3.3 million MNT...

... In the first half of the year since the management privatization, the hospital employees' average wage increased slightly. As the standard, it was recommended and implemented at the hospital to link salaries with work and efficiency, which resulted in the improvement of initiative and reforms in the line of thinking of employees.

... To improve the quality and access to hospital care and service of population in the scope of service, two types of monitoring cards have been collected from the inpatients. It therefore became possible to assess the result of employees' work in reality and to improve employees' knowledge, skills and to motivate them in the future ...

... In accordance with the management contract, signed between the Bayanzurkh District Governor Office, the City of Ulaanbaatar Health Department and the Hospital Management Team in July 1 1997, the City of Ulaanbaatar Health Department evaluated the first half-year's work of Bayanzurkh hospital and found it satisfactory.

*Evaluation of Bayanzurkh Hospital's the first half year operation  
Department of Information, Control-Analysis*

The Board of Directors convenes its meeting once or twice a year and approves the annual financial plan of Bayanzurkh Hospital. The Board assesses the implementation of this plan and monitors the performance of the management contract for the agents of the contract. Thus, through the Board of Directors, the contractors can monitor each other.

Based on the evaluation, the Board of Directors suggests to the Bayanzurkh District Governor's Office and the City of Ulaanbaatar Health Department who signed the contract, whether to extend the contract or to end it upon expiry. After receiving suggestions, these organizations make decisions regarding contract prolongation.

...The Guaranteed deposit

Successful participants are requested to make the 'guaranteed deposit' at a bank. The amount of the deposit is 1250 US\$ (Bayanzurkh Hospital management team deposited 1500 US\$ at a bank) and it equals to 0.5 percent of Bayanzurkh District Hospital's annual budget. Each participant must make the guaranteed deposit, as the City of Ulaanbaatar Health Department must have a financial source when the successful participant would not perform the obligations under the management contract.

For the period of the management contract, the 'guaranteed deposit' will be kept at a bank. Accumulated interest payment during this period will be paid fully to the participant. When the participant does not perform as per obligations in the management contract or makes no profit, some part of the deposit or the entire deposit will be taken away as the income of the City of Ulaanbaatar Health Department...

*The basic part of the management contract  
The tender of Bayanzurkh District Hospital*



Since it had not been decided whether the hospital would be completely privatized, the Bayanzurkh Hospital management team continued to work by extending the contract each year. The legal environment of social sector privatization was complete when an amendment to the Law on State and Local Property was approved on July 10, 2002. In accordance with the Resolution 163 of the City of Ulaanbaatar Health Department on September 17, 2003, the decision was made to privatize the hospital in the first quarter of 2004. According to the result of the management privatization, the hospital will be privatized completely.

#### *1.4. Advantages and disadvantages of management privatization*

The advantage of this pilot privatization is that the hospital will always have customers, since it is the district hospital. Also, because of pilot privatization, it was possible for the contractors to be flexible in negotiations.

One of the reasons for successful privatization was that the team working through the management contract was indeed a capable team.

The health sector being less competitive is disadvantageous to the hospitals, although for some hospitals, which operate with bad quality of service, less competition may be deemed an advantage. Without competition, they are not worried about losing their market share. Less competition always adversely affects the quality of hospital service. This situation provides Bayanzurkh Hospital the advantage of attracting more customers through improvement in quality of their service.

One of the disadvantages of management privatization is that the management of state organizations is by the private sector while their assets are owned by state. Therefore, for the management team, it is difficult to find the sources to finance their extended operations.

. . . When we need to invest in the hospital, the problem is that the hospital is a state asset and we do not have the right to borrow by these assets . . .

*Director of Bayanzurkh hospital*

According to the privatization contract, the first priority of the management team was to reduce the financing from the budget and that goal of the contract received more attention during contract implementation; the management team paid less attention to the service quality.

Since 2000, the final decision has not been clear because the uncertain legal environment. The uncertainty about future could adversely affect efficiency and re-

sult in the loss of time.

## 2. Results of Bayanzurkh Hospital privatization

### 2.1. Before the management privatization

Bayanzurkh Hospital consists of the district's clinic, the children hospital and the consulting center of health. Bayanzurkh Hospital is located in the children hospital that began its operation in September 1983. At the time of privatization, Bayanzurkh district clinic and children's hospital had 155 and 150 beds respectively. In accordance with preliminarily calculations, it was planned that Bayanzurkh hospital would have in total 225 beds, 75 of which would be for the children.

**Table 1: Bayanzurkh district's clinic and children's hospital before privatization**

	Bayanzurkh district's clinic	Bayanzurkh district's children hospital	Bayanzurkh district's consulting center of health
Number of beds	155	150	-
Physicians	9	13	46
Doctors	10	18	7
Nurses	14	18	83
Technical mid-level medical personnel	3	1	13
Administration	11	11,5	19
Ward boys, servicemen	2	2	2
Employees working in kitchen	6	0	-
Employees working in laundry	2	3	-
Total employees	57	66,5	170
Number of patients hospitalized in 1996	3068 (3691 children)	3397 -	
Total bed-day in 1996	44270 (18423 children)	28849 -	
Average bed-day in 1996	14,4 (children 9,4)	10,5 -	
Number of patients in 1996	-	-	189227
Non operation cost in 1996	66755061	33413600	34626063
Operation cost in 1996	15776049	23678673	42319250
Total cost in 1996	82531110	570928273	76945313
Cost of bed-day in 1996	1864	1600	-
Cost of one patient hospitalized in 1996	26901	16807	-
Cost of one out-patient in 1996	-	-	407

## 2.2. After the management privatization

Today there are five medical departments in Bayanzurkh Hospital, which include: two children's departments, two internal disease's departments and an ambulance department of intensive care. In addition, there are departments of paramedics, drug supply, food supply and administration.

### 2.2.1. Organization

After the privatization, first, the organization of the hospital changed. For instance, the new management team was introduced in the operation with three levels of managers to the hospital. The first level manager is a strategic manager and the director of the hospital holds this responsibility. About 70-80 percent of his work is to look after external relations and remaining part of his work is the internal work of the organization.

The second level manager is a tactics manager. This is the responsibility of the executive director and the general physician. About 20-30 percent of their work is to look after external relations and the remaining part of the work is internal work of the organization.

The third level manager is an operational manager. The managers of the departments shoulder this responsibility. They devote themselves fully to the internal work of the organization.

In addition, the old drugstore and the kitchen were changed into the departments of the drug supply and the food supply. The director of the department takes the authority for the department's operation and finance. As a result, the stages of operation of the organization were reduced and the operation became quicker.

After privatization, the hospital management team introduced the 'system of palat'<sup>1</sup>.

The system of monitoring the operation by opinion of inpatients and department customers through a questionnaire has been applied in the hospital for the first time.

**Table 2: Bayanzurkh Hospital customers' satisfaction (percentage)**

		1999	2000	2001	2002	2003
1	In medical treatment and service	86.7	86.3	92	92.3	96.3
2	In behavior of employees	95.1	97.5	97.6	97.8	98.2
3	In hospital facilities	86	92	95	98	98.5

<sup>1</sup> System of palat means that physicians and nurse take care of patients in rooms that are given to them as their complete responsibility.

To improve the efforts and creativity of physicians and workers, the hospital management team used the incentives system. The International Accounting System was used at the hospital for the first time and now the balance is calculated monthly and annually.

### 2.2.2. Economic Indicators

Before 1993, the health sector was financed only from the government budget. Since 1993, the hospital's operational revenue and since 1994, Health Insurance Fund have financed the health sector. The sources of national health sector financing are shown in Table 3.

**Table 3: The sources of national health sector financing (percentage)**

	1994	1995	1996	1997	1998
Government budget financing	54.2	53.1	58	65.8	53.2
Financing from Health Insurance Fund	42	44.2	37.8	31.1	44.1
Own revenue	3.8	2.7	4.2	3.1	2.7
<b>Total</b>	100	100	100	100	100

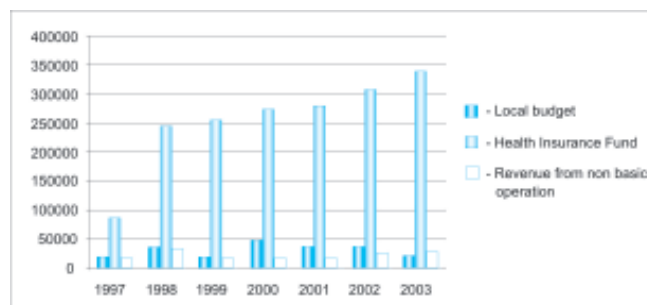
A source of Bayanzurkh Hospital financing is shown below.

**Table 4: Sources of Bayanzurkh Hospital financing (percentage)**

	Last half of 1997	1998	1999	2000	2001	2002	2003
-Local budget	14.02	10.58	5.70	13.96	9.86	9.38	4.85
-Health Insurance Fund	73.40	79.39	89.55	81.68	85.33	84.27	88.26
-Non-basic operational revenue	12.58	10.03	4.75	4.36	4.81	6.35	6.89
<b>Total Financing</b>	100	100	100	100	100	100	100

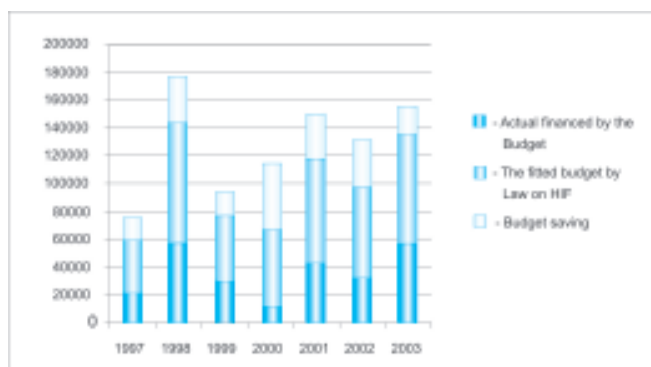
The Health Insurance Fund is the major source of Bayanzurkh Hospital financing and its share is rising continuously. Compared to the structure of the national health sector financing, which has a major share of government budget financing, the financial structure of Bayanzurkh Hospital has very high share of Health Insurance Fund. In addition, own operational revenue of the hospital has continued to increase gradually.

**Figure 1: The financial structure of Bayanzurkh Hospital (thousands of MNT)**



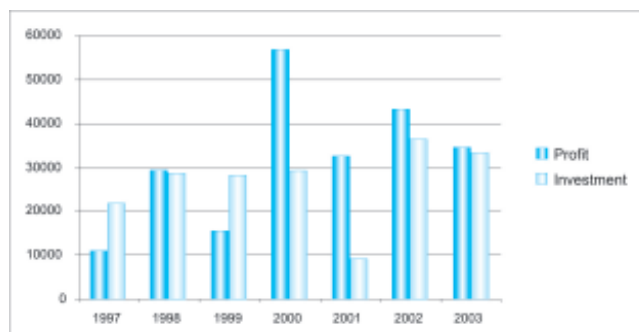
After the privatization, Bayanzurkh Hospital received lesser funds than what it was supposed to receive, 'budget savings' resulted.

**Figure 2: Budget savings of Bayanzurkh Hospital since privatization (thousands of MNT)**



As figure 3 shows, the hospital has made profits but profits have fluctuated dramatically, since 1997.

**Figure 3: Profits of Bayanzurkh Hospital since privatization (thousands of MNT)**

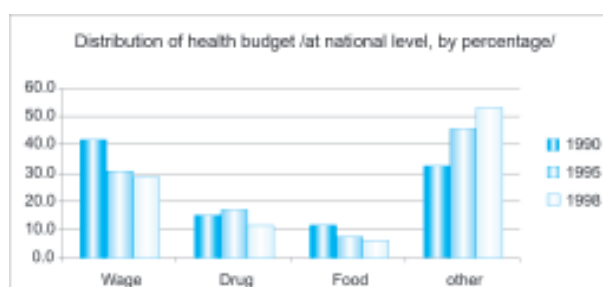


Wages, cost of medications and materials, and food cost were the major part of the total expenditures of the hospital. For example, as the following table shows, these items amounted for 60.53 and 76 percent of the total cost in 2001 and 2003 respectively.

**Table 5: Cost structure of Bayanzurkh Hospital (percentage)**

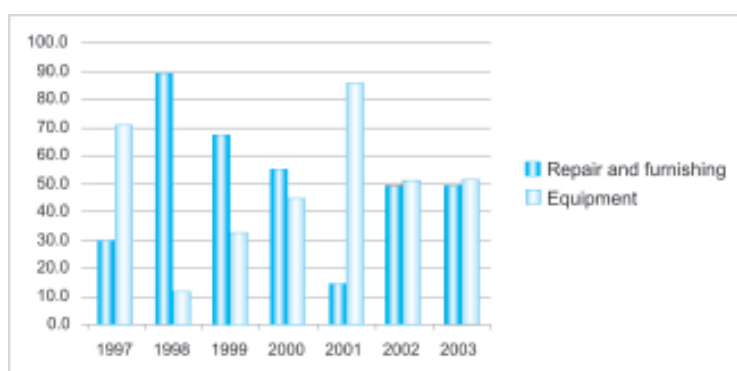
	Last half of 1997	1999	2000	2001	2002	2003
Total costs	100.0	100.0	100.0	100.0	100.0	100.0
1.Wage	23.0	25.6	27.0	28.7	34.5	36.9
2.food cost	8.4	10.5	10.5	7.8	25.8	27.0
3.cost of medications and materials	23.1	28.4	28.8	24.0	9.9	12.1
Total of 1+2+3	54.5	64.5	66.3	60.5	70.2	76.0
4.Other costs	45.5	35.5	33.7	39.5	29.8	24.0

**Figure 4: Distribution of the health budget**



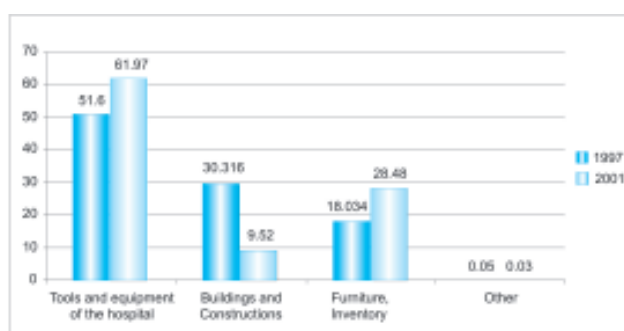
To provide comfort to the employees and patients, Bayanzurkh Hospital made investments in repairing furnishings and necessary hospital equipment.

**Figure 5: Type of investments of Bayanzurkh Hospital**



As a result of investments made, the structure of hospital assets changed significantly. For instance, when the management privatization was carried out in 1997, the equipment and tools of hospital amounted to 51.6 percent of total assets, while in 2001 this proportion increased to 61.97 percent.

**Figure 6: Structure of assets**



Also, as a result of the management privatization the economic capacity of Bayanzurkh Hospital improved.

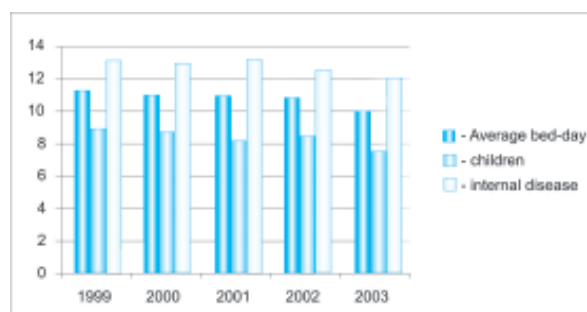
### 2.2.3. Medical indicators

In the management contract, the obligations of the team were to reduce the average bed-day and to provide access and equality of the access to hospital service.

Bayanzurkh Hospital was adjudged "The Best Organization of Health in the city of Ulaanbaatar" in 2003. Bayanzurkh Hospital has 225 beds, of which 75 beds are for children.

From statistical data of the hospital, average bed-day was 11.2 in 1999, but it decreased to 10 in 2003.

**Figure 7: Average bed day coefficient of Bayanzurkh Hospital**

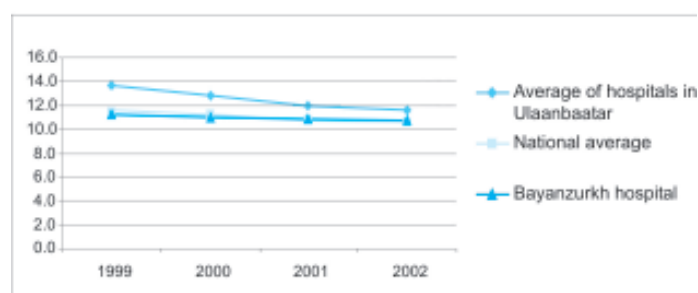


The average bed-day of the national average and Bayanzurkh Hospital is slightly lower compared to average bed-day of other hospitals in Ulaanbaatar. While average bed-day declined dramatically in Ulaanbaatar, for the national average and Bayanzurkh hospital it declined slightly.

Declining average bed-day may be due to following factors.

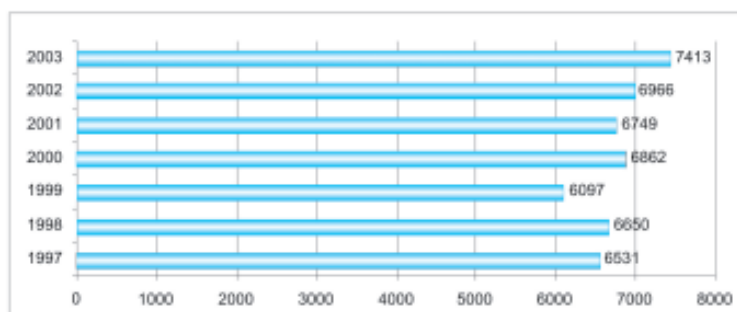
1. The inpatient fee made from Health Insurance Fund is constant at 49000 MNT not depending on days. Therefore, hospitals may try to reduce the days of inpatients in hospitals to increase their revenue.
2. On the other hand, Mongolian patients in general prefer to stay in hospital for a long period of time. Management of hospitals, knowing that, adheres to a policy of shortening in-patient time to reduce related costs and in the case of Bayanzurkh Hospital; it was the actual policy of the management team to reduce average bed-days.

**Figure 8: Average bed-day**



Total inpatients increased slightly between 1997 and 2003. Since average bed-day has reduced, more patients could receive medical treatment.

**Figure 9: Number of inpatients of Bayanzurkh Hospital**





As of 2001, 28 physicians, 53 mid-level medical personnel, 45 nurses, and 2 pharmacists worked for the hospital. The number of nurses per physician increased from 1.06 in 1997 to 1.61 in 2001, i.e. by 51 percent.

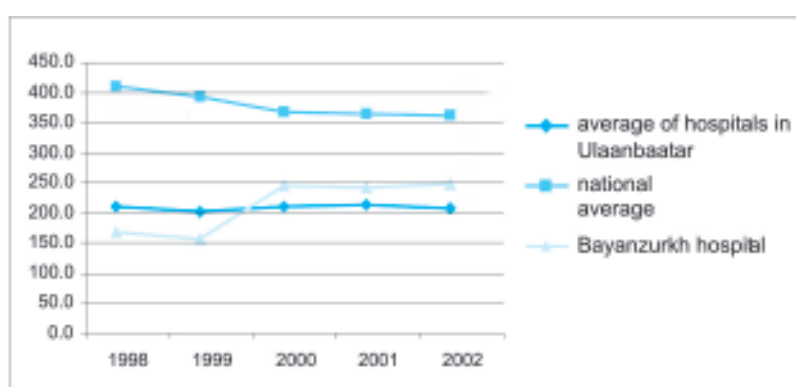
**Figure 10: Total bed-day in Bayanzurkh Hospital /annual/**



As compared to the number of total bed-days of clinic and children hospital of Bayanzurkh district before privatization, the number of total bed-days of Bayanzurkh Hospital is now higher.

Although the number of patients per physician is lower than the national average, it has increased slightly in last three years and it is a little higher than the average of all hospitals in Ulaanbaatar.

**Figure 11: Number of patients per physician**



**Table 6: Quality indicators of Bayanzurkh Hospital (percentage)**

№	Indicators	1999	2000	2001	2002	2003
1	Follows the standard in writing patient's history	51%	52%	77%	78,5%	86%
2	Follows the standard in medical treatment	50%	51%	79%	78%	86,5%
3	Follows the standard in diagnosis	48%	49%	78%	79%	87%
4	Follows the standard in general operation	85%	86%	92%	94%	95%
5	Error of treatment and service	0	0	0	0	0
6	Supply of hospital instruments	82,5%	88,8%	95%	95,2%	97,3%
7	Supply of essential medicines	67,6%	75,9%	78,8%	80%	85,3%
8	Deaths in the hospital	1,1% (69)	0,9% (67)	1% (70)	0,7% (51)	0,7% (54)
9	Adjusting the diagnosis					
10	Involvement of people in analyzing the cause of deaths	92,5% 97,1%	89,8% 88%	96,4% 94,2%	91,4% 92,1%	94,1% 94,4%

*Source: Survey on quality indicators of Bayanzurkh Hospital service for 5 years*

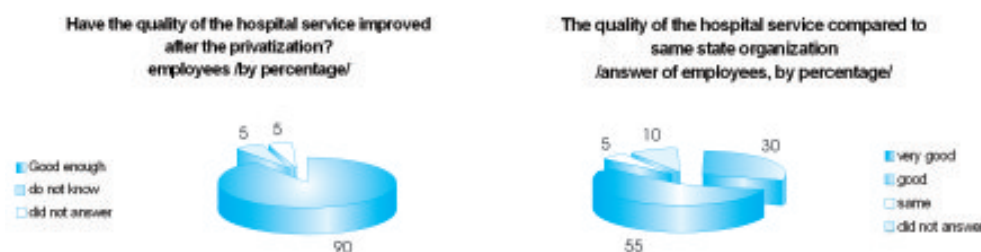
Economic capacity of Bayanzurkh Hospital has improved but medical indicators do not indicate any significant improvement.

*Health Ministry, specialist*

To investigate the outcome of the Bayanzurkh Hospital privatization, we conducted a survey of Bayanzurkh in January 29, 2004. The survey was conducted in three stages.

- The first stage was to interview the director of the hospital about changes in activities of the hospital before and after privatization.
- The second was to interview and to get the questionnaire filled by the physicians and nurses regarding the hospital privatization.
- The third was to interview and to get the questionnaire filled by the patients regarding the hospital privatization.

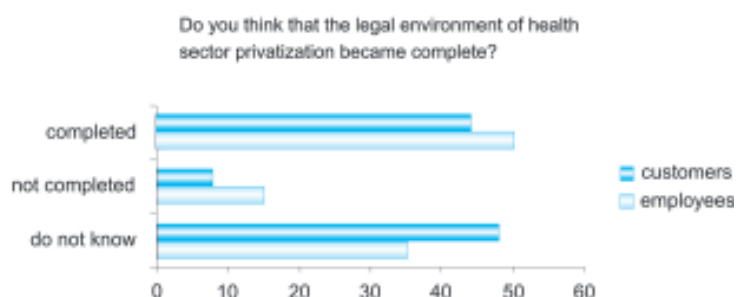
**Figure 12: Quality of the hospital service-answer of employees (percentage)**



When we asked whether the access to health service and its equality has improved after the privatization, 95 percent of employees and 44 percent of customers answered "improved". 5 percent of employees did not answer this question and 28 percent of the customers answered "has not improved".

When asked whether the legal environment of health sector privatization is complete, 70 percent of employees and 68 percent of customers answered positively, 20 percent of employees and 4 percent of the customers were neutral and the remaining 10 and 28 percents employees and customers, respectively, answered in the negative.

**Figure 13: Legal environment of health sector privatization (percentage)**



When we asked about the outcome of Bayanzurkh Hospital management privatization, 85 percent of employees answered "good", 10 percent said they "do not know" and 5 percent answered "bad".

To the question "Is it necessary to privatize other hospitals?" 56 percent of the customers answered positively, 24 percent negatively and 20 percent were neutral.

### 3. Conclusion

1. In article 12.2 of the Law on Civil Health Insurance (as of April 25, 2002), it is indicated that “the variable cost for medical care and services of ambulance and hospitalization insurance takers is prepaid based on monthly schedule of hospital and then the remaining funds will be paid as per the hospital’s performance”. However, this article has been violated in the case of Bayanzurkh Hospital. The payment from Health Insurance Fund was received as prepaid payment but no payment was made for performance. This violation affects the access to health service adversely.
2. In accordance with Article 47.1.2 of the Mongolian Law on Health (the “Civil Rights” provision), one has the right to choose the hospital and physician for one’s medical care. However, in reality people have been served by particular hospitals and physicians because of their residential location, types of diseases, payment made from the social fund and the schedules of hospital services. The aforementioned right has therefore been violated. As a result, there have been adverse effects on the public access to health service and its equality. The market competition in the sphere of healthcare and service has been limited.
3. Although management privatization has been implemented successfully, time has been lost in terms of taking decisions on future privatization.
4. When management is carried out by contract, Board of Directors is more efficient than the contract manager in monitoring the performance of the contract.
5. As a result of the privatization, the efficiency and quality of the hospital service have improved as the management became optimal.
6. After the privatization, the financial independence of the hospital has improved.
7. Mechanism, permitting employees to receive payment according to the accomplished work, has had positive effect on the quality of hospital service and the enthusiasm of employees.
8. Customer participation in the questionnaire surveys increased the possibility of monitoring the work of employees and its quality. As a result, the hospital’s capabilities of self-monitoring increased.

#### 4. Policy recommendations

For the privatization of a hospital, it is optimal that the hospital management is implemented by management contract. Further privatization should be based on the results achieved under the management contract.

However, in this case it is important to indicate clearly how the prospective privatization will be done, if the management contract is to perform well. In the final stage of privatization, the conflict between the management team and the state organization conducting the privatization could arise. Therefore, the success of the management contract has its limits.

In the case of Bayanzurkh Hospital the legal environment was not complete; therefore, it took time to decide whether the hospital would be privatized in the future, though the pilot exercise of the privatization was implemented successfully. Therefore, it is necessary to have the legal environment complete for the health sector privatization.

In the management contract, it is expected that the Board of Directors would monitor the performance of the contract.

It is important that in the preparation stage of privatization, the debt problem must be settled completely. Otherwise, as experience suggests, the problem will affect the efficiency of the hospital adversely.

To increase the competition amongst hospitals, it is necessary to change the situation when patients are assigned to health services in accordance with their physical residence. If this system changed, then it will be easier to create the environment for increased competition, as a result of which the quality of health service will improve dramatically.

It is necessary to make clear the procedures for monitoring the operations and the quality of the hospital after the privatization.

Since quality indicators of hospital services, access to health services and effectiveness are not sufficient indicators, it is not enough to conclude and evaluate only the quality of service and the access to health service.

## A case study of privatization of the Mongolemimpex Company

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## 1. Decision to privatize the Mongolemimpex Company

The Mongolemimpex consortium has been privatized within the framework of the “Health Sector Reforms and Privatization Program”. This program contains justifications, objectives, principles and the range of the health sector privatization.

### *Justifications for health sector privatization*

While in general the health sector indicators have been satisfactory, the current health sector system is inefficient and the quality and outcome of services have been inadequate. This problem has to do with the Mongols’ inclination towards in-patient treatment, a consequence of the former centrally planned system. The health sector system consists of large, inefficient and expensive-to-run hospitals designed for in-patient treatment, which burden the health sector budget. Therefore, the Ministry of Health has focused on improving efficiency and reducing expenditure through the encouragement of preventive and primary healthcare.

The justifications for the health sector privatization are reflected in the Government’s “Health Sector Reforms and Privatization Program” in the following way. “During the last decade the number of cases of noninfectious diseases has increased regularly... and infectious diseases, which affect the population’s health, have burdened the health sector excessively. The need therefore arose for increasing the role of the private sector in the health sector, improving the outcome of health services and increasing efficiency of the health sector. Whereas the number of hospital beds per population ... is ...comparatively satisfactory, ... and hospital bed use ratio is high, the service quality, outcome and efficiency is unsatisfactory. It is not a secret that because of these circumstances many patients who can afford to do so have gone to Huhhot and Beijing looking for health care services with higher quality, more specialized equipment and more modern technology. Therefore meeting the demands of these patients, changing the technology and developing the hospital management are crucial for improving the quality and efficiency of health care services.”

### *Objectives of the health sector privatization*

The objectives of the health sector privatization are to support competition, improve the quality of health care services and increase role and participation of the private sector in the health sector financing in order to improve the management, expenditure, outcomes and efficiency of the limited resources of the health sector.<sup>1</sup>

<sup>1</sup>The presentation on the “Health Sector Privatization Policy and Guideline” by P.Nyamdavaa, Health minister.

“The purpose of privatization and restructuring in the social sector is to increase private sector participation, support competition, improve the quality of social sector services, and ensuring their quality, efficiency accessibility to all on an equal basis.”

*“Social Sector Restructuring and Privatization Guidelines”, Resolution No.56, July 10, 2002, State Great Hural.*

### ***Principles of the Health Sector Privatization***

The following principles should be followed for the health sector privatization.

- Privatize health institutions, those provide preventive services and medical treatment for infectious diseases.
- Financing the basic medical care services, health monitoring and certified medical services from the state budget
- Leave unchanged the direction and purpose of activities of the privatized health institutions.
- Contracts should include the requirement to improve, not to worsen the current level of health care services and activities so as to evaluate privatized health sector activities.
- Conditions of privatization should be profitable to investors and contractors.

Proposals and initiatives to privatize are responsibility of the ministries of a particular sector. The ministries submit their privatization proposals with privatization methods to the State Property Committee. However the State Property Committee will meet in advance with the ministry and give some advice. Normally, the State Property Committee is the implementing agency of the Government and is responsible for the privatization process.

*Social sector privatization expert, the State Property Committee*

Following these privatization principles the Ministry of Health makes its privatization proposals for health institutions and chooses appropriate privatization methods in consultation with the State Property Committee. The proposal is discussed and approved by the council of the Health Ministry. Currently, Bulganchimeg, the deputy director of the finance, economics, management and planning division of the Ministry of Health is



responsible for privatization issues. Then these proposals are reflected in the Social Sector Privatization Guidelines and discussed and approved by the State Great Hural. The Government issues a decree to privatize according to the approved guidelines.

### *Mongolemimpex and the health sector privatization*

Within the policy of “Public-Private Partnership”, the Ministry of Health has the privatization policy to specifically privatize health sector institutions not directly involved in the healthcare services, such as medications supplying institutions. For example, the Health Minister noted in his policy presentation that the policy is “to privatize health organizations other than infectious disease preventing and treating organizations”.<sup>2</sup> The decision to privatize the Mongolemimpex Company was made within the framework of the “health sector privatization policy”.

With its market share of 40 percent the Mongolemimpex Company has functioned as a monopoly making the drug market imperfectly competitive. The structure of the company had been very expensive, inefficient and it had high operation costs. Its branches in aimags operated with losses. Therefore, it has privatized in order to reorganize, improve efficiency and support competition on the medications market.

- 4.1 The national health policy is an inseparable part of the overall policy of the Mongolian national security.
- 4.2 The national health policy is directed to provide health organizations, animal hospitals and population with qualified and highly efficient medications registered in the state catalogue ensuring accessibility to all on an equal basis, and to form appropriate use of medications.
- 3.1.7 The “List of essential medications” includes names of medications and medical equipment of high importance for diagnosis, treatment and preventive actions within the framework of healthcare services to the population, approved by the central organization of the State administration.
- 4.3 The “List of essential medications” is approved by the central organization of the State administration /hereafter, “related central organization of the State administration”/ responsible for human and animal health issues.
- 4.4 The national drug policy is reflected in the policies of the Government, central administrative and local administrative organizations and it is implemented through their activities.

*“Law on Medications”*

<sup>2</sup> The presentation on the “Health Sector Privatization Policy and Guidelines” by P. Nyamdavaa, Health minister.

The Mongolemimpex consortium has reorganized as a corporation and 49 percent of its equity is to be privatized. The state owns 51 percent of its equity in order to control the implementation of the “medications policy” and to ensure uninterrupted supply of essential medications. The Mongolemimpex Corporation is responsible for supplying more than 200 types of essential medications and it is the only medications supply network with standard medications storage facilities in each aimag. The Ministry of Health considered the privatization method of retaining 51% of shares in government ownership as necessary to control the medications policy implementation and not to allow changes in the directions of activities.

In 2001, the Mongolemimpex Company was included in the “list of health sector organizations to be privatized” of the “Health Sector Restructuring and Privatization Program,” an appendix of the draft of the Government’s decree.

## 2. Privatization Process of the Mongolemimpex

The State Property Committee executes privatization procedures for any state owned organizations. In the following section the privatization process of Mongolemimpex is discussed in detail.

### *Decree to privatize*

On the February 11, 2003, within the framework of the “**Health Sector Restructuring and Privatization Program**” the Government approved decree No 34 on “**Approving the list of social sector organizations to be restructured and privatized in 2003**”. In the appendix of the decree it is recorded that the Mongolemimpex Company is being organized as a corporation and 49 percent of its equity is being privatized through an open auction as one package.

### *Privatization process*

On July 17, 2003 the State Property Committee approved decree No. 473 about “Selling 49 percent of equity or a package of 19605123 units of equity of the state owned corporation Mongolemimpex at an open auction”.

As of the December 31, 2002, the value of Mongolemimpex had been evaluated by 3.3 billion tugrug and the bottom line of the 49 percent of equity to be privatized was equal to 1.6 billion tugrug. Therefore, an auction with the bottom line of 1.6 billion tugrug was announced. However on the August 25, 2003 no one participated in the auction because the announced starting price was too high. Thus the State Property Committee announced a second auction attempt on September 12, 2003. However no one participated in this auction either.

On September 18, 2003 the State Property Committee approved decree No. 587, which lowered the bottom line to 970.2 million tugrug. At the auction on October 10, 2003 a private investor, Mr. T. Zhigmiddagva, bought the package of 49 percent by 970.5 million tugrug.

### 3. Privatization of Mongolemimpex

The Mongolemimpex Corporation is located in the district of Sukhbaatar in Ulaanbaatar city.

#### 3.1 Before privatization

The Mongolemimpex Concern is one of the oldest Health Sector organizations. Established in 1923, it has a history of more than 80 years and it has been the leading company in medications distribution in the country. In 2003, the State Property Committee reorganized the Mongolemimpex Company as a Corporation.

The Mongolemimpex Corporation has branch companies in 21 aimags including Ulaanbaatar city and it is the only medications-supplying network that reaches soum level customers.

It has a total of 387 employees, 61 of whom work for the branch company (MEIC)<sup>3</sup> in Ulaanbaatar. The Mongolemimpex Corporation accounts for 40 percent of the medications market sale of Mongolia; thus, it is the product leader on the market. All of the branch companies in aimags have standardized storage facilities.

The Mongolemimpex Corporation is responsible for the permanent supply of more than 200 types of listed “essential medications”. It has representatives in the countries of Germany, the Russian Federation and Korea.

#### 3.2 Privatization period

The Mongolemimpex Corporation consists of 22 “Em Khangamj” companies located in 21 aimags and Ulaanbaatar city.

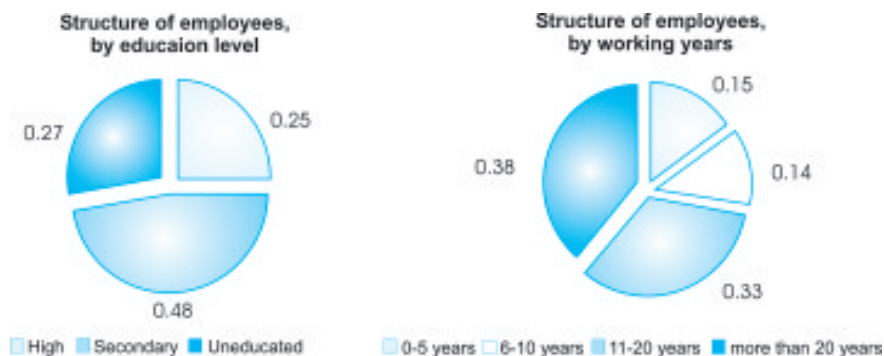
51 percent of Mongolemimpex Corporation’s equity is owned by the State, while Mr. Zhigmiddagva, the owner of the “Kseniya” company, owns 49 percent. The Representative Management Board consists of 9 members: 5 for the State and 4 for the private share. In the 5 members of the State representation, there is 1 member from the Ministry of Health, 2 members from the Government and 2 members from the State Property Committee.

<sup>3</sup> We note the branch company in Ulaanbaatar city as MEIC.

### *Economic indicators<sup>40</sup>*

#### Employees

The Mongolemimpex Corporation has 387 employees. Among them there are 22 directors, 5 department heads, 1 economist, 27 accountants, 31 storekeepers, 262 subordinates. In the following diagram, education and the working years structure of employees are shown.



Approximately half of the employees have secondary education and 0.27 percent have higher education. Looking at professional work experience, 85 percent have more than 6 years working experience, and 71 percent have more than 11 years working experience. Looking at the age structure, no employees are younger than 20, the percentage of 21-30 years is 14.1, and percentage of more than 41 years is 45.6.

#### Revenue, costs and profits

The total net sales revenue of the Mongolemimpex Corporation was 3.6 billion tugrug in 4th quarter of 2003. Of this, 2.2 billion tugrug were made by branch companies in 21 aimags and 1.4 billion tugrug was made by the center company (MEIC).

In 4th quarter of 2003, Mongolemimpex worked with the sales profit of 988 million tugrug. MEIC solely worked with a sales profit of 533 million tugrug. Of 21 branch companies, 4 companies in Bayan-Ulgii, Dornogobi, Uvurkhangai, Khuvsgul worked with sales profit, while others worked with loss. Total profit was 53.1 million tugrug in the 4th financial term of 2003. In 2003, MEIC solely earned a profit of 146.8 million tugrug, while Em Khangamj companies in 21 aimags had losses totaling 93.8 million tugrug. In 2003, the "Mongolemimpex" corporation paid income taxes of 74.0 million tugrug.

<sup>4</sup> The economic indicators were provided by a shareholder, T. Zhigmiddagva.

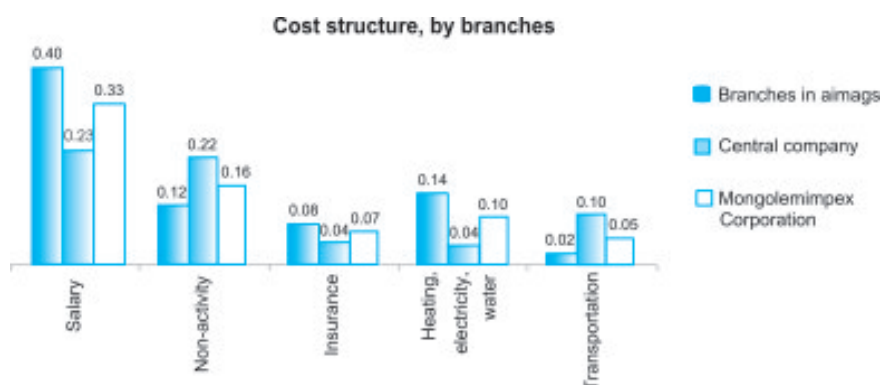
**Table 1. Profit of the “Mongolemimpex” Corporation**

Name of branch companies	Profit	Taxable income	Tax payment	Net profit
Arkhangai	-13.1			-13.1
Bayankhongor	- 5.1			- 5.1
Bayan-Ulgii	7.2	13.5	2.2	5.1
Baruun-Urt	-12.8			-12.8
Bulgan	-15.4			-15.4
Gobi-Altai				
Gobisumber	- 2.4			- 2.4
Darkhan-Uul	- 8.6			- 8.6
Dornogobi	2.6	6.8	0.4	2.2
Dornod	-11.1			-11.1
Dundgobi	- 5.7			- 5.7
Zavkhan	- 8.8			- 8.8
Orkhon	- 3.4	1.0	0.1	- 3.5
Uvurkhangai	4.8	8.0	1.2	3.6
Umnugobi	- 5.7			- 5.7
Selenge	- 2.5			- 2.5
Tuv	- 4.9			- 4.9
Uvs	- 8.4			- 8.4
Khovd	-1.0			- 1.0
Khuvsgul	0.4	4.2	0.1	0.2
Khentii				
EIC <sup>5</sup>	- 93.8	33.4	4.0	- 97.7
MEIC	146.8	238.2	70.0	76.7
Total	53.0	271.7	74.0	21.0

Sources: Economic indicators are provided by a shareholder T. Zhigmiddagva.

In 4th financial term of 2003, the Mongolemimpex Corporation worked with total costs of 1.02 billion tugrug and the share of branch companies cost was 58.2 percent. Share of salary is the highest among other expenditures. Share of salary in total expenditure is 40.0 percent in branch companies, while in MEIC it is 23.0 percent. Moreover, costs related to heating, electricity and water account for 14 percent in branch companies (EIC) compared to 4.0 percent in MEIC. Transportation cost is equal to 5 percent of the total expenditures of the Mongolemimpex Corporation.

<sup>5</sup> EIC is aggregated 21 branch companies in aimags.

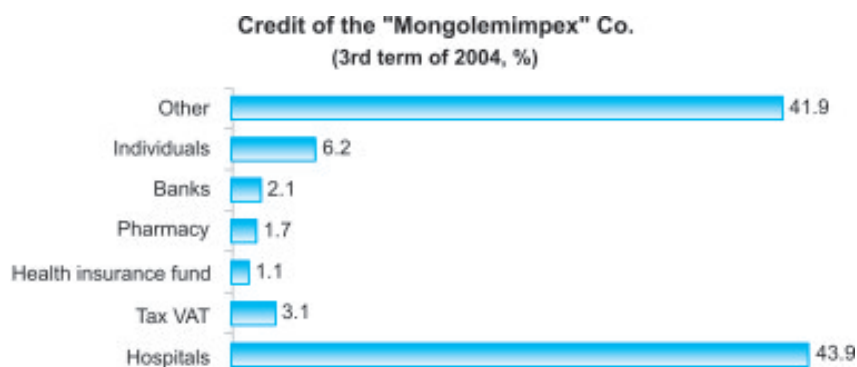


There is a cost category of non-activity cost. This cost accounts for 16.0 percent of total expenditures of the company and it is 6.0 percentage points higher than the cost of heating, electricity and water. "Reception, training, transfer, encouragement" cost is the largest category in the non-activity cost and its share in the non-activity cost is equal to 60.0 percent.

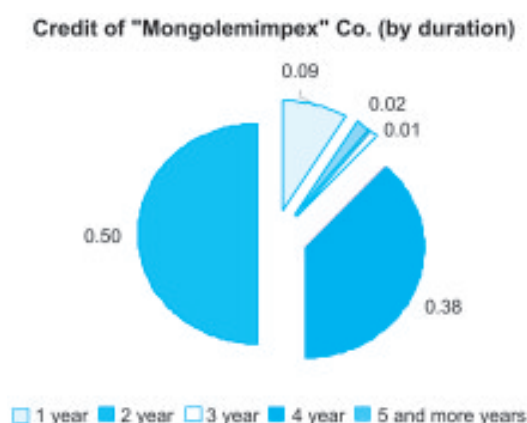
#### Tax, debt, liabilities

In 2003, Mongolemimpex paid a total of 519.8 million tugrug to the government's budget. In 2003, it paid 74 million tugrug worth of income taxes, of which more than 70 million tugrug were paid by MEIC.

One important problem surrounding the the Mongolemimpex Corporation is its credit. In the beginning of 2003, the Corporation had a credit of 979 million tugrug and 57 percent of it was MEIC's credit. In the 3rd quarter of 2003 its credit had increased by 979 million tugrug.



The credit from foreign suppliers is equal to more than 300 million tugrug and it is in the category of "other institutions". Credit from individuals is equal to 104.1 million tugrug. The greater part of MEIC's liabilities date back to before 2000. For example, liabilities older than 5 years are equal to 220.4 million tugrug, that is about 50 percent of the liabilities older than 1 year.<sup>6</sup> However, liabilities 4 years old make up 38 percent.



Bad loans are equal to 253.2 million tugrug totaling 15 percent of the total liabilities. 66.7 percent of the unreliable loans are payments due by the Ulaanbaatar Em Khangamj Company for drugs and that goes back to December 31, 1997.<sup>7</sup>

### Salary

The average monthly salary of Mongolemimpex employees is 105.6 thousand tugrug, this is 40 percent higher than the national average and is 96 percent (almost double) of the health sector average. Salaries vary from 33.6 thousand tugrug to 253.0 thousand tugrug depending on positions and duties. Professionals' salary is between 100.0 to 115.0 thousand tugrug, while service workers' salary is between 33.6 thousand to 98.0 thousand tugrug.

### ***3.3 The period after privatization***

After the privatization of the Mongolemimpex Corporation, a challenging prob-

<sup>6</sup> As of the September 30, 2003.

<sup>7</sup> "Em Khangamj" company of Ulaanbaatar city was closed down in 1997 following the joint order No.A\01\01 by the Head of the State Property Committee and Health Minister. The company was closed and its assets were confiscated and became state property while the company still owed significant payment to MEIC for supplied drugs.

lem emerged: who will be the new director? This problem is very important for the company's future. Therefore, one could observe sceptical and wait-and-see behavior at the company.

### 3.3.1 Who is going to be the director?

49 percent of the Mongolemimpex Corporation's equity was privatized on October 10, 2003 and it went to the ownership of Mr. T. Zhigmiddagva. The new owner and the State Property Committee organized the Board of Representatives (BR) with 9 members.

According to the "Company's Law,"<sup>8</sup> the director would be elected with at least 66.6 percent of the total votes. In the BR of the company, the share of the state representatives is 55 percent, while the private share is 44 percent. Both parties have different nominations for the election of the director of the company. State representatives want to vote for former director Mr. R. Byambaa, while "private" representatives want a new director. Because the share of votes of each parties has not reached the minimum requirement of 66.6 percent, the election procedure of the director has continued for 4 months and has not yet been conclusive (February 20, 2004). If the two parties do not agree on this matter, there is a risk that the selection process could continue for an extended period of time. Both sides understand that the continuation of the disagreement is harmful for the company's productive functioning.

As the former director, Mr. Byambaa said, the continuation of disagreement is related to the privatization method. As the shareholders proportion of 51:49 makes the representation of each side in the BR less than 66.6 percent, the two sides can not reach agreement. In the opinion of Mr. Byambaa, the proportion of 70:30 (state 70 percent) would have prevented this problem.

Nevertheless, the shareholder of 49 percent of the equity, Mr. Zhigmiddagva thinks that this problem can be easily solved. As a shareholder he thinks that the former director Mr. Byambaa, does not have the qualities necessary to change the Mongolemimpex Company in accordance with the contemporary requirements. Therefore, he submitted a proposal for changing the director to the SPC and requested on several occasions, to nominate a person other than Mr. Byambaa. This issue remains unresolved.

<sup>8</sup> "Law of a company".



Generally, the head of the organizations should be a good economist or have a good management team, but not necessarily be a good professional (isn't an economist and a management team a professional?). The medications side should be managed by a professional and a good management team and should lead the organization as a whole. The current organizational structure is enormous and very expensive. The current structure should be changed to improve efficiency through cost minimization. Branch companies will work on the basis of self-accounting. The continuation of disagreement about director after privatization is very harmful to the company.

*T. Zhigmiddagva, Shareholder*

As the Ministry of Health has nominated Mr. Byambaa repeatedly, but nobody has yet been elected and disagreement continues today.<sup>1</sup> Since the continuation of the disagreement is very harmful to the company's normal functioning, the shareholder, Mr. Zhigmiddagva said that he hopes that the SPC will soon solve this problem.

### **3.3.2. Changes after the privatization**

Although, the Mongolemimpex Corporation was privatized 4 months ago, no changes have been made due to the delay in the director's election. Therefore, we studied the privatization process and expected impacts of privatization among three group- managers, employees and clients.

#### ***Structure and organization***

The former manager and the shareholder both answered that the structural change and rationalization will take place in order to eliminate the duplication of duties. Therefore, if the rationalization will take place in order to eliminate the duplication of duties, it will result in the reduction of wastage of outlay and the company will become profitable in the future.

I am not a medications professional. Therefore, I will consider professional's advice for the rationalization. However, as I know the economic side very well, I can rationalize the excess positions.

*T. Zhigmiddagva, Shareholder*

<sup>9</sup> Note of the interview, the February 13, 2004.

### ***Price of product***

According to the shareholder and the former director, the product price will be dependent on changes in the external environment. For example, changes in the exchange rate of the Euro and a change in the export tax policy of Russia, would lead to a higher price. In general, medications prices will remain consistent and it may happen that competition could result in the import of cheaper medications.

### ***Access to and quality of service***

There will be no changes in the access to medications as the supply of essential medications continues though the company's management issues are still unresolved.

Access to medications and equality of access can decline because the transportation cost of medications to remote aimags is very high and private owners may want to reduce this kind of costs. However, there will be no change in the quality of product. Medications supply should be under state control as it is related to national security.

*R. Byambaa, former director*

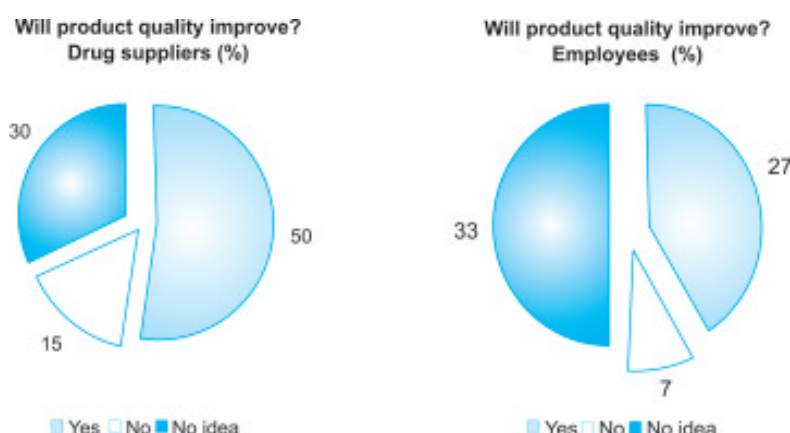
Privatization of the Mongolemimpex Corporation will increase the private sector share in the medications market by approximately 20-percentage points.

50 percent of the client-respondents expect improvements in the quality of products after privatization and 15 percent think to the contrary. On the other hand, 27 percent of employee-respondents expect quality improvements, while 7 percent expect no change.

### **Drug control**

The "Law on Medications" and the "Medications policy" regulate medications control. "State Inspectorate" is the executing body of medications control. The office inspects medications quality and standards of all state and private medications suppliers according to the previously approved schedule. The state control laboratory examines and confirms medications quality. In local areas, medications inspectors are responsible for the medications quality control.

*Expert, Ministry of Health*



60 percent of the client-respondents expect improvements in access and 15 percent expect no improvements, while 13 percent of employee-respondents expect improvement in access and 27 percent expect no improvements.

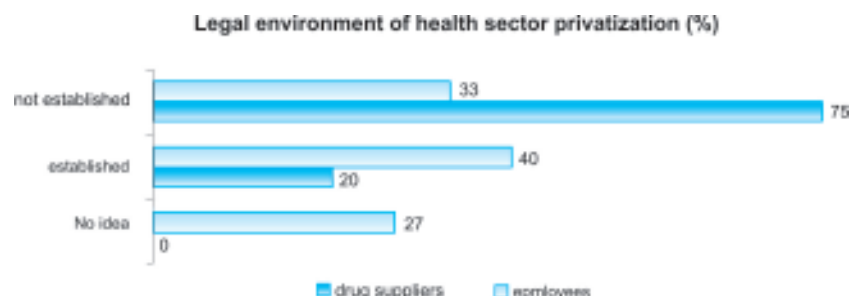
Moreover 45 percent of client-respondents answered “Yes” to the question “Will the equality of access improve after privatization?” while 15 percent answered “No”. 33 percent of employee-respondents answered “No” to the same question, while 53 percent were uncertain.

To the questions concerning medications quality and access, up to 40 percent of employee-respondents gave definite answers such as “yes” or “no”, while the rest were uncertain. The employee-respondents’ answers might be explained by the uncertainty with the selection of the director.

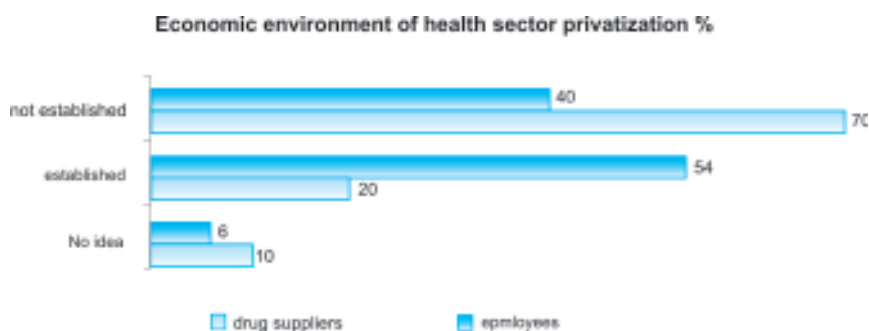
### ***Competition and environment***

The majority of client-respondents (75 percent) expect an increase in medications market competition as the result of privatization of the Mongolemimpex Corporation.

75 percent of client-respondents believe that the legal environment of the health sector privatization is sufficient, while only 33 percent of employee-respondents have the same opinion.



70 percent of client-respondents believe that the economic environment of the health sector privatization has stabilized, while only 40 percent of employee-respondents have the same opinion.



Therefore, clients or drug suppliers have positive expectations for privatization and believe that the legal and economic environment of 'health sector privatization' is sufficient.

### ***Impacts on employees***

The majority of employee-respondents answered that there will be no change in salary, incentives and benefits: 13.4 percent of employee-respondents answered that salary, incentives and benefits will increase despite privatization, 26.7 percent answered that it will decrease, and 40.0 percent answered that there will be no change.

Average salary after privatization, (%)



Incentives and benefits after privatization, (%)



66.7 percent of employee-respondents think that the risk of being dismissed after privatization is high. However, 53.3 percent said that the quality of service and input they provide to the corporation would improve after privatization. 60 percent of employee-respondents expect an increase in their duties and responsibilities.

### 3.4 Lessons and conclusions

#### 3.4.1 Company's actions

The most controversial issue to arise after privatization of the Mongolemimpex Corporation is the election of the company management. The continuation of this debate is related to the privatization method of “51:49” and the related section of the “Law of the Company”.

Obviously, the continuation of the debate is harmful for the company's normal functioning as it may weaken the employees' morale and increase uncertainty about the company's future. For example, the answer “no idea” by the majority of employees, who have better knowledge of the company's functioning and have more information on company activities than outsiders such as clients, might indicate a growing uncertainty within the company.

The current economic indicators of the Mongolemimpex Corporation have shown that the company is running with very high costs and is unprofitable. It has incurred large liabilities, and the tendency continued even after privatization. This shows that it is necessary to change the company's organizational structure. It is interesting to know whether the former director, who has been nominated repeatedly by the Ministry of Health and the SPC, would change the current organizational structure if he becomes a director. This might be a bad example of the government interference in a privatized company's activities and management.

International practices have shown that taking over the control of a company by privatized owners has an advantage of focusing on the profitability of a company, improving the company's functioning, reducing costs and improving efficiency. The main focus of the private sector is the reorganization of the costly structure and the reduction of the company's losses. The rationalization aimed at the elimination of duplicate posts will lead to an increase in employee responsibility. If foreign trading partners are chosen on a competitive and profitable basis, the product price could be reduced.

### **3.4.2 Goals of privatization**

#### ***Role of the private sector in the health sector, competition and efficiency***

The privatization of Mongolemimpex increases the private sector share within the health sector by 20 percentage points. The owners claim that if they can get hold of the management, then the main focus will be the profitability of the company. The control over the company's operations will improve, costs will decrease and efficiency will improve. Medications suppliers expect an increase in the competition on the medications market as a result of privatization of the Mongolemimpex Company. However, the Ministry of Health and SPC create obstacles in the path of the realization of these goals through repeated nominations of the former director.

#### ***Product quality and price***

Quality control over the product will not change as it is exercised through an independent procedure. 50 percent of medications suppliers participated in the survey and they expect improvement in the quality of services. If the company changes its foreign trade partners and improves contracts, the product price could decrease.

#### ***Access and its equality***

60 percent of drug suppliers expect an increase in access to products. However there will be no change in the equality of access.

#### ***Policy Recommendations***

- An in depth study of each privatizing institution is recommended for the health sector privatization. In the framework of the study the following issues should be considered as a whole:
  - Comparative study of activities, basic direction and company's features
  - Make privatization goals related to the peculiarities of the company's

operations.

- Choose a privatization method that complies with the identified goals
- Set control mechanisms and indicators, which examine implementation of goals through the changes after privatization
- Privatization should focus on health sector service quality, efficiency and access rather than the budget income from privatization.
- The state should limit its interference through control of implementation of medications policy.

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## Introduction

As Mongolia began its transition to the market economy, privatization of many state-owned enterprises and industries was initiated, including privatization of many entities, operating in the social sector. One sector, which deserves special attention, is the health sector.

The reason that such importance is placed on this area is that privatization in the health sector can strongly affect the state of nation's health and therefore, is directly linked with the national security issues. As stipulated in the Law on Medications (passed on May 7th, 1998, Section 2, Article 4-1): "national medications policy is an essential component of the unified national security policy". Privatization of the health sector in this regard has specific features that differentiate it from privatization of other industrial sectors.

Privatization in the health sector can considerably affect the quality and varieties of medical services, prices and the degree of their provision, as well as their supply and output. To investigate the impact of privatization in the medications production sphere, the research team conducted a case study of one of the largest national producers and suppliers of medications, the Emiin Uildver Company.

## 1. Introduction to the Emiin Uildver Company

### *1.1. The legal framework of activities of the Emiin Uildver Company*

The legal framework for the privatization of the health sector is very wide. Activities of entities of the health sector are regulated not only by commercial code laws, but also by laws, which regulate health sector services, their quality and provision and organization. While the Emiin Uildver Company is a business entity, the sector's laws must regulate its operations.

One of main laws, which determine the status and operations of the Emiin Uildver Company, is the Medications Law, which defines the company as a medications provision entity (Medications Law, Article 6, 6-11, dated May 7th, 1998):

"6.1 Following organizations are recognized as medications distribution organizations:

6.1.1. Emiin Uildver;

6.1.2. Medications distribution organizations;

6.1.3. Medications stores"

The company activities are regulated by the State in accordance with the Law on Medications, which states that the main aim of the law is to regulate production, import, exchange, storage, provision, usage and inspection of medications for human and animal medical assistance”<sup>1</sup>.

In accordance with the law, the Emiin Uildver Company is responsible for the following actions:<sup>2</sup>

“The medications production must satisfy the following basic criteria:

- 10.2.1. to possess technology, which satisfies domestic and international requirements for production of medications;
- 10.2.2. to be located in buildings and possess equipment, which satisfies hygiene and health requirements for storing and producing medications;
- 10.2.3. the raw materials for medications must have passed inspection from a specialized institution and be registered in the national register of raw materials for medications;
- 10.2.4. the production must take place according to technological requirements and the plant staff must be properly trained
- 10.2.5. the firm must organize inspection over intermediate and final products, and provide conditions for quality control for each lot of products;
- 10.2.6. the packaging and labels for medications must satisfy quality requirements;
- 10.2.7. The products must meet quality requirements”.

In this way, the Emiin Uildver Company must operate so as to fulfill its obligations before shareholders and in addition its products must meet stringent quality requirements. These requirements are the same for other medications companies and are one of the factors, intensifying competition on the medications market.

### ***1.2. History of privatization of the Emiin Uildver Company***

Before Mongolia’s transition to market economy, the Emiin Uildver Company was the only medications plant in the country and it was fully state-owned.

In accordance with the social sector policy documents, “the Law on Amendments to the Law of State and Regional property,” 2002 and the Government decree No 34, which was based on the “Guidelines for Reforms and Privatization in the

<sup>1</sup> Law on Medications, May 7, 1998.

<sup>2</sup> Law on Medicationss, 1998, May 7, Article 10.

Social Sector," approved by Decree No 56, 2002 of the Government of Mongolia, the Government included the Emiin Uildver company in the list of entities to be privatized in 2003. The company's privatization was completed at the beginning of 2004.

The main policy strategy for privatization in the health sector, adhered to by the Ministry of Health, recommends that the "essential medical assistance and basic medical services for the general population must remain state-owned, while non-essential medical services and assistance should be privatized". The Ministry of Health therefore applies this criteria for the selection of the entities for privatization.

In deciding upon the privatization of the Emiin Uildver Company, the following justifications were made by the Ministry: the industry has witnessed an increase in a number of private entities in medications production, import of medications increased, the company's recent business performance was not satisfactory, and the state ownership seemed to hamper its business performance. It was assumed that the privatization of the company to a management team, which would improve its operations, might be more beneficial.

The Guidelines for Privatization of State Property for 2001-2004, approved by Great Hural resolution No 10, 2001, contained the following directions for reforms in the social sector: "The main aim of reforms and privatization in the health sector is a better quality and more equal provision of medical services through the promotion of competition in the industry, expansion of involvement of the private sector in the financing and management of the social sector on the basis of a clarification of government duties regarding healthcare". In this respect, the privatization of the Emiin Uildver Company is in accord with the general directions of reforms in the health sector, being implemented by the Parliament and the Government of Mongolia. The privatization of the Emiin Uildver Company transforms the medications production sector in Mongolia into a completely private sector, enables the largest national medications producer to fully participate in the market competition, which may result in lower prices and better quality of the industry's products.

However, the pharmaceutical industry itself is a very specific industry, and it is still too early to make the final assessment of the results of the company's privatization, as demonstrated in subsequent sections of the study.

The process of privatization of the Emiin Uildver Company itself took place in accordance with policy guidelines and government documents, mentioned above, and 2 teams participated in the privatization bidding. The team led by the former manager of the plant, won the bid and privatized the plant in accordance with bidding guidelines. The team was backed by a commercial bank and received about 60% of shares, the rest of shares were received by other owners. Conditions of the backing by a commercial bank were as follows: the interest rate on loan was 2.5% monthly interest

rate and the total loan amounted to about 800 million MNT. However, taking into consideration the current market for medications in Mongolia, these loan conditions seem to be harsh and the management team faces a daunting task in repaying the loan.

The contract, which the management team signed with the State Property Committee, also contained goals, which were difficult to achieve. For example, the team promised not to change the production profile of the plant for 2 years, not to reduce current labor force by more than 30%, to improve the quality of medications and to increase the output of strategically important medications. The obligation to increase output may be the one, which will create problems, as can be seen from the study of the medications market in Mongolia in the following sections. Half of the company’s management board is now comprised of company executives and the other half are outsiders.

## **2. Study of market of the Emiin Uildver Company**

### ***2.1. Medications supply: production and import***

Activities of the Emiin Uildver Company and other national medications producers are regulated by the Law on Medications (1998), which also regulates the import of medications into Mongolia and their distribution. As a commercial entity, the Emiin Uildver Company is also the subject of jurisdiction to commercial laws, such as the Law on Economic Entity (1991) and the Law on Income Tax of Economic Entities (1993). Medications companies are not entitled to various tax exemptions according to the law. These laws in general govern the market structure of the medications industry and supply of medications in Mongolia.

The market for medications in Mongolia is very competitive. The law on medications and the law on health liberalized production of medications. Currently more than 20 companies are allowed to produce medications in Mongolia. The law on medications (Article 8) also liberalized imports of medications, which greatly increased medications imports in Mongolia. Before the liberalization, only the state-owned company Mongolemimpex enjoyed the monopoly status of medications importer, but currently the number of companies and individual businessmen, importing medications, has greatly increased and the competition is intense.

Thus, the Law on Medications is playing an important role in shaping the market structure of medications in Mongolia. The essence of changes brought into the health sector by the Law on Medications is that the law has simplified the process of establishing new medications firms and importing medications, so relatively competitive market was created. In economic terms, the law created free entry conditions for the rise of new medications producers. In an industry with free entry, long-term com-

petition drives prices down so that firms cannot earn high profits for long periods of time. Yet, the international pharmaceutical industry is one industry with the highest profit margins. This discrepancy between the industry performance of Mongolia and developed countries is studied in specific detail within this case study.

The study will begin with the introduction of the current medications market in Mongolia. According to some estimates, 16 million US dollars worth of various medications are sold on the Mongolian market annually. Approximately, 80% of these medications are imported and the remaining 20% of medications worth approximately 3.2 billion MNT are produced domestically.

#### Medications Market structure in Mongolia

20% of total medications supply is produced by domestic companies and 90% of it produced by firms, other than the Emiin Uildver company

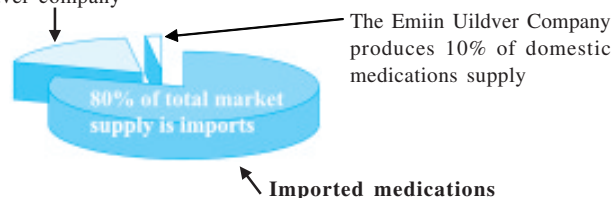


Figure 1. Medications Market of Mongolia and the share of the Emiin Uildver Company

From the total domestic supply of medications, equal to 3.2 billion MNT, roughly 10% of domestically produced medications are products of the Emiin Uildver Company. In 2002-2003 the Emiin Uildver Company sold 260-300 billion MNT worth of medications. In terms of market share, by international standards this market share is quite large.

As a result of the growing import of medications, fast rise of domestic producers, the medications market in Mongolia is being transformed into a competitive market. Now let's turn attention to the demand for medications in Mongolia.

## 2.2. Structure of the market demand for medications

While the Law on Medications regulates market supply of medications in Mongolia, demand for medications depends on two main demand channels.

One is the dispensary distribution channel, defined in the Law on Medications as wholesale and retail sales of medications through medications distribution organizations, such as drugstores. The following laws regulate this kind of demand: Health Insurance Law (2002), Law on Mental Health, and Law on Medications. In particular, the Health Insurance Law has special importance for medications distribution. If a

patient buys medications at a drugstore using a doctor’s prescription, the Health Insurance Law, Article 12.8 stipulates that “an insured person, who is purchasing medication in accordance with the prescription of a doctor, overseeing the district, and the medications is included in the list of essential medications to be sold at a special discount, a proper refund should be paid to the person from the insurance fund.” Article 12.9 of the same law further determines that the list of essential medications and the refund percentage must be determined by the Civil Health Insurance Council and made public”.

The demand for medications sold through drugstores, greatly depends on prices and whether buyers can obtain discounted prices for medications. In the latter case, sales of medications would increase and the provision of medications to society improve as well. Increased sales of medications could directly benefit firms, the producers of medications. However, this is far from current reality. In the course of the case study, the provision of medications was investigated through drugstores and 19 drugstores from 19 or 100% of drugstores, which answered our questionnaires, reported that they do not discount medications prescribed by doctors. On the other hand, drugstores do not require purchasers of medications to present doctor’s prescriptions. In reality, this situation leads to unavailability of medications discounts for population and actually increases their prices.

A second major kind of demand for medications are medications purchased in bulk by hospitals for in-house treatment purposes.

State-owned hospitals must purchase medications in accordance with the Law on Selection of Goods and Services for Procurement to State and Regional State Property (2000), Law on Financial Management of Budgetary Organizations (2002). Since these laws regulate the process of procurement of medications by state hospitals, they significantly affect the market operations of medications producers and sales of medications.

When the state-owned hospitals purchase medications, they must announce tenders or bidding for the medications supply. The tenders are organized in accordance with the Law on the Selection of Goods and Services for Procurement to State and Regional State Property and the main principles are as follows:

“Article 38.3.1. For goods and services, valued between 5’000’001-10’000’000 MNT, or for project cost between 10’000’001-20’000’000 MNT - district, soum and organization’s tender committees;

38.3.2. For goods and services, valued between 10’000’001-50’000’000 MNT, or for project cost between 20’000’001-75’000’000 MNT - aimag, capital and agency tender committees;

- 38.3.3. For goods and services, valued between 50'000'001-100'000'000 MNT, or for project cost between 75'000'001-150'000'000 MNT - ministerial tender committees are entitled to select suppliers in accordance with the law".

Currently, tenders, organized by hospitals became ubiquitous and it is becoming vitally important for medications firms to successfully participate in hospital tenders.

Generally, this is the current situation on the market for medications in Mongolia.

### **3. Analysis of the Emiin Uildver Company's activities**

#### ***3.1. Advantages of the Emiin Uildver Company***

The Emiin Uildver Company is one of the officially registered 24 medications producers in Mongolia and one of few domestic companies, which has equipment, satisfying international standards for medications production.

In 2002, the Emiin Uildver Company had about 10% of the share of the domestic production of medications, 56 employees and produced 33 liquid medications types, 26 kinds of medical lubricants, 30 kinds of medications pills, 34 kinds of other medications and medical supplies. The company is one of many large domestic producers: in 2002, the total sales of the company reached 268 million MNT, from which the company paid 62 million MNT to the state budget and it had a national network of 1400 distributors.

Figures 2, 3: Products of the Emiin Uildver company.

For long periods of time, the Emiin Uildver Company was the sole producer of medications in Mongolia and even in the initial years after transition to market economy, it still operated as a state-owned monopoly.

The government supported the company in various ways. For example, at the end of the 1990s the government had arranged 29 million MNT in investment in the company for the renovation and repair of a heating system and temperature sensors for manufacturing buildings of the company. The repair work was financed by the grant from the TACIS project of the European Union. The equipment was imported from Europe and the government arranged its tax exemption from custom duties.

Figures 4, 5: Equipment and renovation works financed by the EU project.

The Emiin Uildver Company is relatively large compared to the other private producers of medications and has 4 well-equipped manufacturing buildings. However, increasing competition of the domestic medications market created various difficulties for the company. As a result of trade liberalization, increasingly more medi-



cations are being imported from China, the Russian Federation and the European Union. The liberalization of business practices eased the entry of newer small-scale private companies into medications production. These factors led to intensifying competition on the domestic medications market.

### ***3.2. Weaknesses of the Emiin Uildver Company***

The conditions of the medications market in Mongolia have greatly changed from the time when the Emiin Uildver Company was the sole state-owned monopoly-producing medications in Mongolia. After market reforms the Emiin Uildver Company has struggled to adapt to the growing market competition. In 2003, the company's share of domestic sales of medications did not exceed 10% and was equal to only 2% of the total market for medications in Mongolia.

In 2002, the company's production of fluid medications fell by 60%, of medical lubricants by 49%, of pills by 52% and production of other medical products fell by 26-66% as compared with 2001 levels, including a 87% fall in production of infusion medications.

In general, the company's production fell by 55% from 2001 to 2002 and for the first 3 quarters of 2003 the output decreased by 59% from the 2001 output level.

One of reasons for these changes is that the import of medications was liberalized, thus, increasing the inflow of foreign medications into Mongolia and the number of private medications producers rapidly increased. The new companies produce the same medications as the Emiin Uildver Company but at a lower cost and, in some cases with better design and packaging.

One specific feature of the Mongolian medications industry is that the number of medications officially tested and licensed for production by health authorities is relatively small. Further, to develop new medications and to receive licenses for their production takes at least 5 years; the research and development of new medications is very costly. This is the main reason why the Emiin Uildver Company and the new private companies both produce the same set of medications with similar names and similar contents.

This makes products of both the Emiin Uildver Company and its rivals identical or homogeneous, so that consumers select medications based on price and the market for medications becomes a homogeneous good market where the products are similar and only price matters.

In such market structure, price competition prevails. Since the new companies are mostly relatively small-scale companies with little overhead costs, their production costs are low. In the price competition these companies have a cost advantage



over an older and larger rival, the Emiin Uildver Company.

Using economics terms, the current Mongolian medications market has been transformed into a market that is not highly profitable for the older incumbent enterprise (the Emiin Uildver company), and more profitable for entering new enterprises. The main reason for the cost disadvantage of the Emiin Uildver is that its large buildings and production facilities became a mild burden on the company. Thus increasing its production costs, despite some of its facilities remaining idle.

The Emiin Uildver Company occupies a relatively large area, with 4 manufacturing buildings representing a high fixed cost, despite only 2 of the buildings being used. The plant operates at only 30% of its planned capacity increasing its average costs and driving output prices up, thus making the Emiin Uildver company's medications expensive and reducing its total sales.

The Emiin Uildver Company also faces other obstacles:

1. The Emiin Uildver Company's management did not study the market well and misjudged output volumes of pill medications, thus accumulating excessive inventories of unsold pill medications. Such mismanagement mistakes were partly caused by the fact, that previous managers did not possess adequate expertise in this field.
2. The company's pricing was not flexible enough: when the company was state-owned, the management did not pay much attention to flexible pricing policies and marketing studies and did not discount the price of pills when the demand for the particular pills was low.

### ***3.3. Opportunities and perspectives***

In 2003 the company's efforts to improve its situation achieved a number of positive results. Taking into account the trend of falling sales, the company's management undertook a number of steps to reduce overhead and variable costs. Wage cost decreased by 2 million MNT, a number of management positions was reduced by 1 position, indirect costs were reduced by 18 million MNT, and sales increased to 333 million MNT compared to 268 million MNT in 2002. Some statistics provided by the company show that production stabilized at 2002 levels.

Still, the company continues to face a number of hurdles. Compared to 2002, pre-tax profit fell in 2003 from 104 million to 73 million MNT. In 2002 the number of distributors decreased from 1400 to 1150. Since the company's main economic results in 2003 declined in comparison with the preceding year, average salaries of managers fell by 2.6% and the average wage of company workers fell by 7.3%.

The company’s management is planning the following steps to overcome these hurdles:

1. The company is planning to reduce medications prices by as much as 20-50%, thus bringing the company’s formerly state-controlled prices in line with the market price of competitors (especially prices for pill medications). In cooperation with other producers, the company is planning to increase prices of vitamins and penicillin and in general to pursue flexible pricing policies.

This decision can be directly traced to the inability of both the Emiin Uildver Company and the private companies to develop new medications for the market. Therefore, all companies produce similar medications, and the largest medications producer; the Emiin Uildver Company is the price leader. This means that other smaller private companies use the Emiin Uildver Company’s prices as a gauge to set their own prices lower than the Emiin Uildver Company’s prices.

If this situation continues for a long period of time, the Emiin Uildver Company will have less opportunity to prevail in the price competition as the company has higher costs and therefore cannot compete in terms of price alone.

The company needs to find a way to escape from this unbeneficial situation, to demonstrate to customers that its products differ from those of its rivals and to attract customers. To differentiate its products from products of other companies, the Emiin Uildver company must advertise its own brand if it is unable to develop new medications. It is necessary to consider various advertising possibilities in order to advertise its brand, including design, packaging and quality guarantees.

2. A second step is a technological renovation, improvement of quality and an increase in the number of products. One possible way is to start the production of syringe injection medications.
3. The company is also considering a diversification away from specializing in the production of medications into lucrative imports of medications and the regional distribution of medications.

This step may signal that under current conditions of financial markets of Mongolia with very high interest rates, production may be not profitable and diversification is necessary.

4. The Emiin Uildver Company is planning to actively participate in hospital medications supply tenders and to increase its specialization in the produc-

tion of essential medications. The company is planning to promote its sales through both the wholesale and retail distribution networks and through hospital tenders.

The hospital tenders enable the company to sell large portions of its products at a time and the budget-financed medications procurement is important for long long-term planning of the company's activities. Still, such tenders are very competitive and may have low profit margins.

#### **4. Assessment of the impact of the Emiin Uildver Company's privatization on the provision of medications and healthcare situation**

##### ***4.1. Expectations of customers***

In the course of the case study, the research team studied 20 drugstores and investigated the expectations of drugstores' representatives regarding the expected impact of the Emiin Uildver Company's privatization on medications supply.

90% of the drugstores that participated in the study are expecting the Emiin Uildver Company to pursue more flexible pricing policies. The number of customers (drugstores) who believe that the quality of the company's products will improve as a result of the privatization exceeds the number of customers who think otherwise by threefold.

60% of customers believe that the provision of medications made by the company will improve as a result of its privatization and 65% believe that equality of the provision of the company's products will improve.

As mentioned, one aim of privatization programs adopted by the Government and Parliament of Mongolia was to increase competition in the health industry. 90% of customers believe that this goal will be achieved by the privatization of the Emiin Uildver Company.

As to the degree to which the legal and economic conditions for privatization in the health industry are mature enough, 65% of study participants consider economic conditions and 75% of participants consider legal conditions for privatization as mature on average or mature enough in general.

Three fourth of the customers think that the privatization of the Emiin Uildver company was a correct decision and 50% think that further privatization in the health sector is necessary, while the number of those opposing it is 30%. Participants also think that the privatization in the health sector must give high priority to the consider-

ation of public interest, pay more attention to prices and services charges and should not worsen the quality of provided services.

The study of drugstores shows that the customers of the Emiin Uildver Company in general tend to agree with the privatization guidelines and privatization policies adopted by the Government and Parliament of Mongolia.

#### ***4.2. The social impact of the Emiin Uildver Company’s privatization***

It is becoming clear that the privatization of the Emiin Uildver Company is going to intensify the competition of the medications market. The company’s management is starting to implement flexible pricing policies, improve its marketing and diversify its operations. As a result of these steps, the company and customers believe that medications prices will likely decrease and in the short term the provision of medications will improve. This belief was the underlying factor, when the Government and Parliament were adopting policies on the privatization of the Emiin Uildver Company.

However, it is more difficult to say what results the privatization will bring in the long term. One possible problem is that the Law on Medicationss obliges the Emiin Uildver company to satisfy many difficult requirements for medications production, while at the same time the import of medications is relatively liberalized.

Since the financial capabilities of many medications companies are weak, the companies cannot afford investments in the research and development of new medications. Additionally, their licensing, testing and production have limited capabilities in international marketing.

While the world market for medications is very competitive, pharmaceutical companies can have high profit margins by developing and patenting new medications. However, the financial weakness of the Mongolian medications companies precludes them from such profitable research and development. The competition of the medications market of Mongolia is generally becoming a price competition and the number of medications is limited. Excessive price competition in the long run may harm domestic producers by not allowing them to accumulate enough funds to invest in research and development.

Excessive price competition may cause many companies to abandon the production of medications and leave the medications production sector. A company such as the Emiin Uildver Company, with its large-scale production and costly facilities may become a company that cannot afford engaging in excessive price competition and may be forced to leave the market.

The Emiin Uildver Company is the only Mongolian company that is capable of the research and development of new medications. Excessive price competition as

well as increasing imports may lead to a fall in the domestic production of medications, an increase of share of imported medications and ultimately results in higher prices in long run. This situation will adversely affect national health security and worsen domestic provision of medications.

The current procedures for controlling the import of medications seem imperfect because they allow not only the inflow of imported medications and create problems for domestic producers but they also allow the inflow of counterfeit medications. Counterfeit medications are a direct threat to national security and represent an enormous danger for the Mongolian population.

## 5. Recommendations

International experience shows that the import of medications is tightly controlled in many developed countries. Medications must pass various tests and the inspection of medications is a multi-stage time-consuming procedure, which is an important part of national health policy.

History has shown that medications, which are not fully tested, may have dangerous side effects for an individual's health. It is even more evident that counterfeit medications represent even larger danger, as they do not have any quality guarantees.

Current Law on Medications of Mongolia contains various requirements for medications production and liberalizes the inflow of imported medications. This puts domestic producers in unfair competition conditions and concurrently creates problems for national health security.

The medications inspection mechanism and import requirements specified in the law must also be improved. This also can be said about the quality and inspection of medications production procedures.

The ultimate goal of the Mongolian Government and Mongolian health organizations is to create a stable and high quality supply and provision of medications for the population of Mongolia. This is the ultimate condition for securing national health.

Therefore, privatization itself is not the main goal of the health sector policy-making process. It is ubiquitous in the world that medications companies are private but when privatization policies for the sector are being worked out, policymakers should take into account specific features of the health sector.

Based on these suggestions, the research team makes the following recommendations for privatization of the health sector:

1. To improve inspection and control over medications production irrelevant of the ownership of the medications companies.

2. Control over the import of medications should be improved as fast as possible. The inflow of counterfeit medications must be stopped and the professional control and inspection of imported medications must be strict.
3. Domestic pharmaceutical companies must be supported in research, development, testing and producing of new medications. Investment made in the research and development of new medications may be exempt of taxation and favorable credit conditions must be created. This will promote the transformation of the current price competition on the medications market of Mongolia into the competition based on the quality of medications. This will require changes in related legislation.
4. The national health insurance system should be improved and the medications must be provided on the basis of doctor’s prescriptions. In that case, medications prices may be discounted and the goal of the provision of quality to the population at relatively cheap prices can be achieved.

We believe that if the above mentioned conditions are satisfied, a national system of medications production, distribution and provision, which can deliver quality medications to the population, protect the national security interests and satisfy public needs in better provision of medications can be created.

## Chronology of Privatization and Reforms in the Health Sector of Mongolia, 1991-2003

	Laws, resolutions, decrees	Description
<b>1991</b>		
03.18	The draft of Law of privatization was processed.	Discussed at the meeting of Government and delivered to the State Small Hural for approval.
05.22	The law of privatization was approved.	This law consists of 5 chapters and 21 articles. This law establishes main regulations related to privatization.
06.07	Mongolian government published a list of enterprises to remain fully or partly owned by the state.	According to this decision, more than 20 enterprises will remain in state ownership, including such economic units as the MIAT Company, pharmaceutical plant, gold mining enterprises, roads, road construction units, geology and 'geodesy' funds, some agricultural and livestock objects, and over 50 units are to be partially privatized, which include fuel and electric enterprises, mining companies, communication companies and some transportation and construction organizations.
<b>1995</b>		
01.12	L.Enebish, the chair of Commission of Privatization, reported on the current situation and submitted proposals outlining future tasks of the Mongolian Government regarding privatization to the session of parliament, the State Great Hural.	The State Great Hural approves the "Guidelines for State Policy on Privatization" after discussing the report. The SGH also notes that the first stage of privatization has been finished and legal, economic and social conditions for citizens to own property have been established. State Guidelines of privatization determined the following goals: <ul style="list-style-type: none"> <li>to establish an independent structure to represent the state as an owner of state property</li> <li>to use various separate or combined methods of privatization</li> <li>to use widely other forms of privatization such as reduction of state participation</li> <li>to assist reforms of privatized enterprises</li> <li>to establish a secondary stock market</li> <li>to include foreign investors into privatization</li> <li>to start the housing privatization by providing legal and regulatory framework</li> <li>to privatize infrastructure and social sector enterprises through establishing a state regulation mechanism</li> </ul>
<b>1996</b>		
05.27	The law on state and local property is passed. <a href="http://www.forum.mn">http://www.forum.mn</a> <a href="mailto:osf@soros.org.mn">osf@soros.org.mn</a>	The law is passed in March and includes 9 chapters and 83 articles. One of the main sections of this law regulates coordination of the privatization process. In the law the issues related to privatization are defined as follows: <ol style="list-style-type: none"> <li>1/ Selling of the state property should be done in one of following ways: <ul style="list-style-type: none"> <li>open bid,</li> <li>tender,</li> <li>selling shares and equities,</li> <li>transforming a state owned enterprise into a joint venture,</li> <li>sell equities of closed down units,</li> <li>management contract under special supervision,</li> <li>issue of special shares etc.</li> </ul> </li> </ol> <p>In the law, application of these methods is defined in detail.</p> <ol style="list-style-type: none"> <li>2/ Every year, according the guidelines to privatize state property approved by the State Great Hural, the Government will issue a list of enterprises and equities to privatize, and the State Property Committee will implement the</li> </ol>

07.31	The State Property Committee was established by the resolution of Government and structure and regulations of the Committee were approved.	State Property Committee is set up with units such as the unit of registration and monitoring of state property, unit of standards, unit of privatizations, division of provision of state organizations and administrative department etc. The State Property Committee consists of 9 members whose appointment is approved by a resolution of the Government.
09.30	Privatization commissions of aimags are abolished and representatives of the state property committee to aimags are appointed.	
<b>1997</b>		
03.05	<b>The guidelines of privatization of state property in 1997-2000</b> are approved by the decree of the Government	The main part of the directions is devoted to the selection of methods for privatization and ensuring open and transparent privatization process without excessive bureaucratic interference. The objects for privatization are divided into three groups, which are immovable assets, and large and small enterprises.
03.10	The first national-wide state property census is conducted.	7788 units are included in the census and state property of 1531971.5 million MNT is accounted for.
04.01	"A general guideline of privatization in health sector" is published.	According to this guideline, important decisions, main principles, and possible positive and negative outcomes of privatization are outlined.
06.11	Rules of privatization bids amended.	The change to the rule of open bid: registration of participants to be done secretly and bids to be received in closed boxes.
07.01	The pilot program of privatization of the Bayanzurkh Hospital started.	The pilot program begins by signing a three-party contract between the Management team, the Governor of Bayanzurkh District and Health Bureau of Ulaanbaatar city.
07.02	Decree No 160 of the Government is approved.	The decision to privatize Bayanzurkh Hospital within the framework of the pilot program on a non-profit base is made in accordance with the Directions of privatization of state property in 1997-2000.
09.02	Seminar on privatization in health sector is organized.	The seminar on privatization for the representatives of aimags and cities is organized.
10.29	Decree No 218 of the Government is approved.	It is decreed to privatize soum hospitals on a basis of management contracts to increase economic efficiency and improve a quality of health care.
11.19	The joint order of A/383/395 is approved.	The decision to start the pilot program to implement the management of soum hospitals on a management contract basis is made.
<b>1998</b>		
01.01	Start of the pilot privatization of soum hospitals.	The pilot privatization starts in 47 soum hospitals in 16 aimags.
02.13	Additional changes to the bid rules.	Additional changes to the rule concerning organizing and implementing public open bids and to the rule concerning closed bid are added.
<b>1999</b>		
	A proposal of "The program of privatization in the health sector" is drafted.	This program establishes a framework for privatization, reforms in the health sector and defines policies and methods for the implementation of the program.
05.13	The decision on transferring state property to local administrations was made.	By the resolution No 29, 1999, of State Great Hural, state property of 225 billion MNT value is transferred from the state to the possession of aimags and capital.
07.01	The management contract of Bayanzurkh Hospital is extended.	The contract was extended by the order No A/184 of Minister of Health and Social Security regarding the performance of activities of the privatized Bayanzurkh Hospital.
12.	The pilot program of privatization of soum hospitals is terminated.	After observations of results of the pilot program to privatize management of soum hospitals based on contracts, the pilot program is terminated by the joint order No A/325/233 of ministers of Health and Social Security and Finance.
<b>2000</b>		
05.	The action program of the health sector is drafted.	The program drafted by the Ministry of Health and Social Security is approved by the decree No 72 of the Government.



11.09	The state property census takes place.	The plan for the census of state property and the rules to implement it is approved.
<b>2001</b>		
01.25	The guideline of privatization of state property for 2000-2004 is approved.	The guideline to privatize state property in 2001-2004 is approved by the resolution No 10 of State Great Hural in 2001. According to the guideline, combined methods of privatization should be used to ensure fulfillment of the main principles of privatization such as transparency, attention to efficiency after privatization and attraction of foreign investment, etc. The directions for privatization of the social sector and banking and finance sector areas are defined.
	"The program of reform and privatization of social sector" is amended.	The program determines risks, which may hinder the implementation of privatization and actions of the government necessary for reduction of these risks, are outlined.
03.15	Census of state property is completed.	The results of the census of state property are discussed and it is decided to report upon them to a Government meeting and to the State Great Hural. In total 857 organizations, 600 of them were budgetary organizations, 215 states owned enterprises and 4 banks with 84 branches are included in the census and property of 2107174.3 million MNT is accounted for.
<b>2002</b>		
07.04	The Law on Amendments to the Law on State and Local Property is passed.	
07.10	The changes added to the law on state and local property.	Section No 7 entitled "Reform and privatization in the social sector" is added to the law on state and local property. Main aim of the added section is that the law states that besides upholding the main principle of not changing directions of activities after privatization, other methods such as privatization of management on a contract basis, provision of healthcare and services according to a performance contract, privatization by reducing state share of ownership may be used in the privatization of the social sector.
07.10	"The guideline of privatization and reforms in the social sector" is approved.	This guideline is the main document for privatization and reforms of health, education, science and social security. In this guideline, the main purposes of privatization in the social sector are defined as <ul style="list-style-type: none"> <li>• increasing participation in the private sector,</li> <li>• support of competition</li> <li>• improvement of the quality, access to and efficiency of services.</li> </ul>
12.31	The Government holds discussions with the Standing Committee of State Great Hural.	In accordance with the Law on Amendments to the Law on State and Local Property, the Government holds consultations with the Economic and Social Policy Committee of the State Great Hural concerning the list of social sector organizations to be privatized and reformed in 2003.
<b>2003</b>		
02.11	A list of organizations to be privatized is made public.	The appendix to the resolution 34 of the Government contains the list of organizations in the social sector as well as other properties owned by state to be privatized and reformed in 2003.
	Emiin Uildver, a state enterprise, is privatized.	In accordance with the list of organizations to be privatized and reformed, the Emiin Uildver is reorganized as a shareholding company and 100% of shares are sold at through a tender.
10.10	The Government sells 49 percent of shares in the Mongolemimpex Company.	In accordance with the list of organizations to be privatized and reformed Mongolemimpex is reorganized as a shareholding company and 49% of shares are privatized through an open bid.

# A STUDY ON PRIVATIZATION OF RURAL HOSPITALS

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## Overview

As of January 2004, more than 1500 health organizations have been registered in Mongolia, 648 of which were located in rural regions. These local health organizations can be classified by type and ownership: 411 of the rural health organizations are hospitals, including 351 state owned hospitals and 60 private hospitals.

The privatization of health organizations in rural areas was initiated in September 1996, when the State Property Committee, Ministry of Finance, Ministry of Health and Social Security, Ministry of Education and World Bank jointly started the first project of privatization of the social sector in Mongolia and after a few months a pilot program on privatization of rural hospitals was launched.

According to the decree of the Government of Mongolia No 218 on 29 October 1997, a pilot program to privatize *soum* or village hospitals through management contracts was launched with the aim of raising economic efficiency and the quality of healthcare services of rural hospitals. In joint order A/383/395 of ministers of Finance and Health and Social Security, regulations and rules for management privatization of *soum* hospitals on the basis of contracts were defined. The pilot program started in 1998.

In May 1999, the health survey team of the Board of Information, Analysis and Assessment of Ministry of Health and Social Security monitored, analyzed and evaluated the process and results of implementation of the pilot program of privatization of *soum* hospitals. The team of the Board of Information, Analysis and Assessment of the Ministry of Health and Social Security documented actions which were executed on government and local levels in order to implement the pilot program, analyzed results of the pilot program and issued recommendations concerning extension of the pilot program.

## Actions of the Ministry of Health and Social Security

The evaluation study noted that the Ministry of Health and Social Security had undertaken the following steps in order to implement the test program:

1. The actions, which were implemented by the Ministry of Health and Social Security-
  - a) In order to conduct the experimental privatization of *soum* hospitals, the training was organized for the representatives of doctors and social policy government officers in December 1997.
  - b) The management contract type and indicators to evaluate and monitor the quality of healthcare and activities of *soum* hospitals that were implementing the pilot program, were set up by the order No A/42 of the Minister of Health and Social Security in 1998.
  - c) Over 50 people received advice regarding the pilot program to privatize *soum* hospitals on the basis of management contracts.

## Actions of local administrations

The evaluation study also noted steps undertaken by local administrations in the framework of the pilot program implementation.

2. The actions implemented by the local administrations were:
  - a) Councils for project selection were established on the orders of local governors.
  - b) Administrations of aimags were provided with brochures and information related to the pilot program of privatization of *soum* hospitals.
  - c) Conditions and rules to announce the tender and to select best projects were processed and delivered to all *soums*. Information and news related to activities of the *soum* hospitals involved in the pilot program were presented through the regional press.

In total, 47 *soum* hospitals in 16 aimags were selected for the privatization of management contract from 134 privatization proposals submitted to the tender committee, including, for example, the hospitals of Lun, Jargalant and Bayantsagaan *soum* of the Tuv aimag.

## Results of the monitoring and analysis

The evaluation study concluded that the program had both successes and fail-

ures. The successes of the pilot program were as follows:

Positive results of the pilot program were:

- The habits and thinking of doctors and workers of the hospitals changed, the attitude of employees improved and their work efficiency improved from the managers' point of view.
- The management teams were working efficiently to improve the quality of healthcare, reduce costs of services and fulfill obligations stipulated in the management contracts.
- The management team of some *soum* hospitals renovated the structure, rules and internal regulations and instructions of the hospital.
- Some management teams were taking initiative in working to make investment and repair /reconstruction/.
- There were some improvements in the quality of healthcare, characters of workers and indicators of social health.

The study also found the following negative results and problems associated with the pilot program:

- Some *soum* hospitals could not implement the pilot program with satisfactory results because local governors lacked the knowledge and understanding of the pilot program to evaluate activities of the private organizations and persons on the basis of management contracts.
- Some *soum* governors disregarded and discriminated privatized hospitals because they did not understand the main goal and importance of this pilot program.
- Hospital activities were hindered since they could not receive budget and health insurance financing in time from local administrations.
- Increase in debt of some hospitals badly influenced the hospital finances.
- Some hospitals could not work regularly because of deterioration of buildings, surrounding area and equipment.
- Participants of privatization bids did not have sufficient knowledge concerning methods for preparations of privatization project proposals and their training was unsatisfactory.
- Some management teams used remote management style and this negatively influenced activities of hospitals.

## Conclusions

The team of the Board of Information, Analysis and Assessment of the Ministry of Health and Social Security made the following conclusions based on the study:

1. The implementation of joint order No A/383/395 of ministers of Finance and Health and Social Security issued on 19 November 1997 and the decree No 218 of the Government of Mongolia on 29 October 1997 was evaluated as unsatisfactory.
2. The fact that some *soum* hospitals involved in the pilot program failed to make progress in improvement of their activities negatively affected the importance of the pilot program.
3. There was no unified perception of importance of privatization in the health sector; the organization of preparations for privatization and implementation of the pilot program failed to adequately address specific regional features and the preparations for the pilot program were not adequate.

The pilot program was terminated as a result of the assessment study in 1999. After the end of the unsuccessful pilot program of privatization of the local hospitals so far no additional attempts to privatize local hospitals have been made.

From the point of view of the pilot program, the attempt to reduce centralized administration in the health sector, which was expected as a result of implementation of the program, as well other expected results of the privatization of rural hospitals were not achieved because of inadequate preparations.

The pilot program was assessed as unsuccessful. One reason for the failure of the pilot program, it is believed, is that *soum* hospitals have limited markets for their services. Therefore, reforms to improve the operations of local health organizations seem to be more suitable than direct privatization of these organizations.

In 1999, based on the evaluation of results of the pilot program, according to which the management of *soum* hospitals was privatized based on contracts, a contract draft for management privatization as well as regulations defining the procedures of setting up result contracts with the management of *soum* hospitals were outlined and approved by an order No A/305 of the Minister of Health and Social Security.

Currently, the general direction of the privatization of rural health organizations and reforms of the health sector is still based on management contracts, which have to be signed with the Citizen's Representatives Hural of aimags (local provincial parliaments). This can be seen in the appendix of the Government decree No 34 issued on 11 February 2003, which contains a list of organizations to be privatized in the health sector and describes the methods of their privatization.

## Experiences of transitional and less developed countries in privatization

Health sector privatization is one of the hotly disputed issues not only in transition economies, but also in highly developed economies. The privatization of the health sector is connected to the healthcare quality and problems related to the access of health care.

The privatization of the health sector is closely related to the questions concerning quality and access to services of the health sector.

### Health sector reform priorities

<b>Developed/industrialized Economies (Japan, Australia, New Zealand, Singapore)</b>	<b>Newly Industrializing Economies (Honkong, Malaysia, Korea, Thailand, Indonesia)</b>	<b>Transitional Economies (China, Mongolia, Vietnam, Cambodia, Laos, Myanmar)</b>
Rising costs and excessive demand Long-term care for ageing population Provider payments methods Separation of funding-purchasing functions. Hospital autonomy	Rapid growth with negative effects on the government-provided health services Restructuring of hospital systems and/or health care financing Problems of national health insurance Problems of differential access and quality	Uneven development and disparities arising from lack of new distributive mechanisms Problems of inefficiency and inappropriate use of technologies, medications and equipment Problems of regulating quality and standards Potential for improving efficiency and equity in expanding social health insurance

The problems related to the privatization and reform of the health sector within transitional economies are that of equality, efficiency and effectiveness. The issue of access and distribution of health care equality is related to access equality (who pays? and who benefits?), the issue of provision and production of health services is related to efficiency (demand and supply) and the issue of quality and standards of health cares is related to effectiveness (outcomes and results).

## **The notes on health sector privatization in Uzbekistan<sup>1</sup>**

The research on the impact and efficiency of healthcare on the poor was done in the Uzbekistan Living Standard Assessment and reorganization of facilities, payment rules, privatization and health rights were defined by institutional arrangements. According to the research, private payments for health services were significant and the cost and quality were caused concerns for the poor. The organization of facilities was initially unequal thus, affecting the lives of the poor negatively. In Uzbekistan, doctors and patients are often unclear as to who should receive free services from which facilities because of an underdeveloped legal and regulatory framework and lack of transparency. Also, according to the research, the conclusion was made that 2/3 of health care service users made unofficial payments and specific specialized care services disappeared because of privatization. Increasing costs of chronic/catastrophic care influenced the process in such a way that it led to an increase in the number of people living in poverty.

## **Health Care and Privatization: Lessons from Mozambique<sup>2</sup>**

-Less developed countries have encountered financial constraints offering free universal healthcare to the public. Providing such services is problematic due to insufficient resources.

After independence in 1975, the Mozambican government established a national primary health care system to reach its poor rural population. The system was so successful that the World Health Organization cited it as a model for developing countries. The IMF compelled Mozambique to limit total spending in specific sectors because the government had an enormous international debt burden. Therefore, the Mozambican government diverted scarce resources from health and education to international lenders.

In Mozambique, the emergence of the private health sector has had a negative impact on the public system that serves the poor. A two-tiered health system has emerged in which the poor people continue to seek treatment in the under-funded, understaffed, demoralized state sector while the small group of large urban-rich elites receive services from the increasingly well-endowed private clinics that have emerged in the country. Many poorly paid government system workers now have a second job, either in the private sector or as home doctors, so as to make ends meet. Medicines and equipment frequently disappear from the public warehouses and pharmacies, and then reappear in private clinics and local markets where they are sold for profit. The overall effect has been the continued deterioration of the quality of public sector services

<sup>1</sup> Uzbekistan Living Standards Assessment, 2000

<sup>2</sup> Health Care and Privatization: Lessons for East Timor from Mozambique, James Pfeiffer, 2000

and the accumulation of resources in private clinics. At the same time, the introduction of fee payments for many basic services within the public sector has resulted in the predictable decline in the number of people using these services.

### Notes on health sector reform in Poland<sup>3</sup>

Since the early 1990s Poland has been seeking political consensus on a sound strategy for transforming the healthcare system under the conditions of the market economy.

Reform in Poland's healthcare system is required at many levels and financial resources are severely limited. Weak economic conditions have exacerbated health problems in an ageing population. Healthcare providers and managers are accustomed to limited accountability, inefficiency, and powerlessness to effect change. Providers are also demanding better working conditions and compensation and currently attain these in part through private practice and informal payments. Many hope for a dramatic solution in the adoption of a new national health insurance scheme. The design of such a scheme has been debated intensely.

Even with a new insurance scheme an inequitable system segregated by income as well as geography, worsening health conditions and increased popular frustration and disappointment are still possible. These risks are greatly increased when even the right health insurance scheme is implemented without adequate attention to and preparation of the essential preconditions for successful health financing reform. Designing a program for reform must include comprehensive strategies to assure an effective transition. This must include managing changes in four major areas: financing, provider payment, healthcare delivery, and consumer behavior.

Financing: the capacity to collect, organize and distribute resources for health care;

Provider payment: the use of financial resources in ways that gives providers incentives for quality and efficiency;

Structure, function and regulation of the provision of health care services: the establishment of modes of healthcare delivery which can manage resources effectively, achieve quality and satisfaction, and adapt to the health needs of the future; and,

Consumer expectations and behavior: creating a new public sense of responsibility, solidarity.

The most important issues in the reform of insurance system are:

- the risks of high administrative costs and regulation difficulties with multiple insurance funds
- inequities and financial difficulties arising from selection problems

<sup>3</sup> Notes on Health Sector Reform in Poland, Berman.P, Ryz.A, Roberts.M, Campbell.P